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The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Cumulative Bulletin (C.B.) is composed of reprints of the weekly Internal Revenue Bulletins (I.R.B.s) issued during the year, bound together to form the C.B. Volume 1 contains I.R.B. issues 1 through 26 and Volume 2 contains I.R.B. issues 27 through 52. Public laws relating to taxes are published in Volume 3 of the C.B. If needed, additional volumes are published and labeled consecutively.

The C.B. also includes the following items:

- Numerical Finding List.
- Finding List of Current Actions on Previously Published Items.
- Code Sections Affected by Current Actions. This list is organized by code section and identifies the actions that impact the code section.
- Cumulative List of Actions on Decisions (if applicable).
- Cumulative Lists of Disbarments and Suspensions (if applicable).
- Index.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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Cumulative List of Actions on Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletins are consolidated semiannually in the Cumulative Bulletins.

The Commissioner ACQUIESCES in the following decision:

Roosevelt Wallace v. Commissioner[1]
Docket Number: 4637–03
128 T.C. No. 11 (April 16, 2007).

The Commissioner does NOT ACQUIESCE in the following decisions:

Snider v. United States; Turley v. United States,[2]
468 F.3d 500 (8th Cir. 2006),
petition for reh'g en banc denied,
No. 05–3636 (8th Cir. Feb. 1, 2007)

United States v. Roxworthy,[3]
457 F.3d 590 (6th Cir. 2006),
rev'g No. 04–MC–18–C
(W.D. Ky. Apr. 4, 2005)

[1] Acquiescence relating to whether certain payments made by the Department of Veterans Affairs under the compensated work therapy program described in 38 U.S.C. section 1718 are exempt from federal income tax as veterans' benefits.

[2] Nonacquiescence relating to whether a special agent's disclosure of the identity of a taxpayer under investigation to a third-party witness is not authorized by section 6103(k)(6); whether even if the disclosure was not authorized, the good faith defense provided by section 7431(b) does not apply; and whether section 7431(c)(1), in providing for statutory damages of $1,000 per "act of . . . disclosure," provides for statutory damages based on each item of return information disclosed during a single interview and for each person who heard the disclosure.

[3] Nonacquiescence relating to whether an accounting firm's opinion letters, issued to a company while the company's federal income tax return was being prepared, are protected by the work product doctrine.

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007

Name	Address	Designation	Date of Reinstatement
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007

Name	Address	Designation	Date of Suspension
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007

Name	Address	Designation	Date of Suspension
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007

Name	Address	Designation	Date of Suspension
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007

Name	Address	Designation	Date of Suspension
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007

Name	Address	Designation	Date of Suspension
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007

Name	Address	Designation	Date of Suspension
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 54.—Credit to Holders of Clean Renewable Energy Bonds

What is the new address to submit *by mail* applications for allocations of clean renewable energy bond volume cap to finance qualified clean renewable energy projects? See Notice 2007-56, page 15.

Section 475.—Mark to Market Accounting Method for Dealers in Securities

26 CFR 1.475(a)–4: Safe harbor for valuation under section 475.

T.D. 9328

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Safe Harbor for Valuation Under Section 475

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document sets forth an elective safe harbor that permits dealers in securities and dealers in commodities to elect to use the values of positions reported on certain financial statements as the fair market values of those positions for purposes of section 475 of the Internal Revenue Code (Code). This safe harbor is intended to reduce the compliance burden on taxpayers and to improve the administrability of the valuation requirement of section 475 for the IRS.

DATES: *Effective Date:* These regulations are effective on June 12, 2007.

Applicability Dates: Section 1.475(a)–4, concerning a safe harbor to use applicable financial statement values for purposes of section 475, applies to taxable years ending on or after June 12, 2007.

FOR FURTHER INFORMATION CONTACT: Marsha A. Sabin or John W. Rogers III (202) 622–3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1945. Comments on the accuracy of the estimated burden and suggestions for reducing the burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, D.C. 20224.

The collection of information in these regulations is in §1.475(a)–4(f)(1) and §1.475(a)–4(k). This information is required by the IRS to avoid any uncertainty about whether a taxpayer has made an election and to verify compliance with section 475 and the safe harbor method of accounting described in §1.475(a)–4(d). This information will be used to facilitate examination of returns and to determine whether the amount of tax has been calculated correctly. The collection of the information is required to properly determine the amount of income or deduction to be taken into account. The taxpayers providing this information are sophisticated dealers in securities or commodities.

Estimated total annual recordkeeping burden: 49,232 hours.

Estimated average annual burden per recordkeeper: 4–6 hours.

Estimated number of recordkeepers: 12,308.

Estimated frequency of recordkeeping: Annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books and records relating to the collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

Background

This document contains amendments to 26 CFR Part 1 under section 475 of the Internal Revenue Code (Code). Section 475 was added to the Code by section 13223(a) of the Omnibus Budget Reconciliation Act of 1993 (Public Law 103–66, 107 Stat. 312). Section 475(a) generally provides that the securities held by dealers in securities must be valued as of the last business day of the year at fair market value. Section 475(e) allows dealers in commodities to elect similar treatment for their commodities. Under section 475(f), if a person is engaged in a trade or business as a trader in securities or a trader in commodities, the person may elect for the section 475 mark-to-market regime to apply to their trade or business.

Section 475(g) directs the Secretary to prescribe regulations that may be necessary or appropriate to carry out the purposes of section 475. The legislative history of section 475 indicates that, under this authority, the Secretary may issue regulations to permit the use of valuation methodologies that reduce the administrative burden of compliance on the taxpayer but clearly reflect income for Federal income tax purposes. On May 5, 2003, the Treasury Department and the IRS published in the **Federal Register** an advance notice of proposed rulemaking (Safe Harbor for Satisfying Certain Statutory Requirements for Valuation under Section 475 for Certain Securities and Commodities) (REG–100420–03) [68 FR 23632] (the ANPRM); Announcement 2003–35, 2003–1 C.B. 956 (see §601.601(d)(2)). The ANPRM solicited comments on whether a safe harbor approach using values reported on an applicable financial statement for certain securities may be used for purposes of section 475. On May 24, 2005, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking (Safe Harbor for Valuation under Section 475) (REG–100420–03, 2005–1 C.B. 1236 [70 FR 29663]) (the

NPRM). The NPRM set forth a possible safe harbor for valuing these securities and asked for comments on various aspects of the safe harbor. A public hearing was held on September 15, 2005. The IRS received written and electronic comments responding to the NPRM. After consideration of all comments, the proposed regulations are adopted as amended by this Treasury decision. The amendments are discussed in this preamble.

Explanation of Provisions and Summary of Contents

Overview

Section 475(a) requires dealers in securities to mark their securities to market. Section 475(e) allows dealers in commodities to elect similar treatment for their commodities. If the security or commodity is inventory, it must be included in inventory at its fair market value. If it is not inventory and is held at the end of the taxable year, gain or loss is recognized as if the security or commodity had been sold for its fair market value on the last business day of the taxable year.

Although the term "fair market value" has a long-standing and well-established meaning within the tax law, it is sometimes difficult to determine the fair market value of certain securities and commodities. This has impeded the efficient administration of the mark-to-market system under section 475. Consequently, with a view to improving the administrability of the valuation requirements of section 475, the Treasury Department and the IRS issued the NPRM, which set forth a safe harbor for valuing securities and commodities under section 475.

These final regulations adopt the approach of the NPRM with the modifications discussed in this preamble.

Underlying Principles of the Safe Harbor

The safe harbor generally permits eligible taxpayers to elect to have the values that are reported for eligible positions on certain financial statements treated as the fair market values of those eligible positions for purposes of section 475, if certain conditions are met. The safe harbor is based upon the principle that if the mark-to-market method used for financial reporting is sufficiently consistent with the mark-to-market method required by section 475, then the values used for financial reporting should be acceptable values for purposes of section 475. To ensure minimal divergence from fair market value under tax principles, these regulations impose certain restrictions on the financial accounting methods and financial statements that are eligible for the safe harbor and also require certain adjustments to the values of the eligible positions on those financial statements that may be used under the safe harbor.

The safe harbor and its various requirements and limitations are based upon the business model for derivatives dealers that was described in comments received in response to the ANPRM and the NPRM. According to these comments, dealers seek to capture and profit from bid-ask spreads in the marketplace by entering into balanced portfolios for their derivatives, that is, positions that offset each other, either individually or in the aggregate. Although dealers may have some open positions, they seek to have balanced portfolios with a majority of positions offsetting each other. Those offsetting positions generally remain on dealers' books over the terms of the positions.

The spread between bid and ask values contains the dealer's profit, which compensates the dealer for all risks and expenses. The creation of a balanced portfolio may be seen as giving rise to a synthetic annuity, with a value that is largely immune from market-related changes in the values of the component positions. At the time the dealer has entered into the offsetting positions and created the synthetic annuity, all steps required to earn the income from the synthetic annuity have been completed. Recognizing the present value of the income attributable to the bid-ask spread is appropriate in the taxable year the synthetic annuity is created. For a matched book of eligible positions, such as a dealer's portfolio of interest rate swap contracts, use of bid or ask values approximates realization accounting and fails to recognize in income the present value of the synthetic annuity in the taxable year that the synthetic annuity is created. The final regulations are to be applied in a manner consistent with the premise that the present value of the synthetic annuity should be recognized in income not later than the taxable year in which the synthetic annuity is created.

Commentators described a different business model for securities that are not derivatives, commonly known as physicals. Under this model, dealers plan on rapid turnover of the physicals that are traded on qualified boards or exchanges or on liquid over-the-counter markets. Except for those acquired at the end of the taxable year, the acquisition and disposition of a physical occurs within a single taxable year, so that the effect of capturing a bid-ask spread also occurs entirely within that year. Consequently, for securities traded on a qualified board or exchange, as defined under section 1256(g)(7), there is little difference between the results of realization and mark-to-market accounting, and little opportunity for manipulation.

Eligible Taxpayers

The NPRM provided that traders could elect to use the safe harbor. In both the ANPRM and the NPRM, the Treasury Department and IRS asked for comments addressing whether traders in securities and commodities should be able to elect the safe harbor and whether the business model for traders differs from the business model for dealers. The commentators that recommended that the safe harbor apply to traders did so without providing information about the business model for traders and without suggesting how the limitations set forth in the NPRM would apply to traders. Without a full understanding of the business model for traders, the Treasury Department and the IRS have determined that it would be unwise to include traders in the safe harbor at this time. Accordingly, the final regulations provide that the safe harbor is available only to taxpayers who are dealers in securities under section 475(a) or who are dealers in commodities and are subject to the election described in section 475(e)(1).

Eligible Positions

Because financial markets and products evolve rapidly, listing the securities and commodities in the regulations would make the regulations less flexible and dynamic in the future. To ensure that the safe harbor will be adaptable and administrable in a changing environment, the Commissioner will issue concurrently

with these final regulations a revenue procedure (Rev. Proc. 2007–41, 2007–26 I.R.B. 1492) that will list the types of securities and commodities that are subject to the safe harbor. This revenue procedure may be updated as necessary.

It is important to note, however, that the valuation methodology under the safe harbor applies only for positions that, taking into account any elections and identifications that are in effect, are required to be marked to market under section 475. That is, the safe harbor only addresses valuation and does not expand or contract the scope or application of section 475. For example, if a security is not marked to market under section 475 because it has been properly identified as held for investment, then it may not be marked to market for Federal income tax purposes even though the safe harbor election is in effect and the security is properly marked to market on the financial statement in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP). Similarly, if a security is not marked to market on the applicable financial statement because, for example, it is a hedge for financial statement purposes but section 475(a) applies because the security is not a hedging transaction for tax purposes, then the security must nevertheless be marked to market under section 475.

Eligible Method

The NPRM set forth four core requirements that a financial accounting method must satisfy in order to be eligible for the safe harbor. First, the method must mark eligible positions to market through valuations made as of the last business day of each taxable year. Second, it must recognize into income on the income statement any gain or loss from marking eligible positions to market. Third, it must recognize into income on the income statement any gain or loss on disposition of an eligible position as if a year-end mark occurred immediately before the disposition. Fourth, it must arrive at fair value in accordance with U.S. GAAP.

In addition to these core requirements, the NPRM imposed certain limitations to ensure minimal divergence from fair market value. Under the first limitation, the financial accounting method must not result in values at or near the bid or ask values, even if the use of bid or ask values is permissible under U.S. GAAP. This limitation applies to all eligible positions except those that are traded on a qualified board or exchange, as defined in section 1256(g)(7). This limitation ensures that a sufficient portion of the synthetic annuity captured by a dealer is reported in the correct accounting period of that dealer.

Under the second limitation in the NPRM, if a method of valuation is based on the present value of projected cash flows from an eligible position or positions, that method must not take into account any income or expense attributable to a period or time on or before the valuation date. This limitation ensures that items of income or expense will not be accounted for twice, first through current recognition and then again in the mark.

Under the third limitation in the NPRM, no cost or risk may be accounted for more than once, either directly or indirectly. For example, a financial accounting method may allow a special adjustment for credit risk. If, however, a method computes the present value of projected cash flows using a discount rate that takes credit risk into account and the method employs a special adjustment that takes some or all of the credit risk into account, then the method does not satisfy this limitation. This limitation ensures that items of income or expense will not be accounted for twice.

Most of the comments received on the NPRM focused on the core requirements and limitations for eligible methods. As explained in this preamble, the final regulations address those comments, rejecting some suggestions and modifying the regulations in response to others. The majority of the comments focused on (1) requiring changes in value to be reported on the income statement, (2) limiting the use of bid and ask values, and (3) excepting certain types of physical securities from the bid-ask limitation.

Income Statement Requirement — §1.475(a)–4(d)(2)(ii)

Some commentators suggested that eligible taxpayers be allowed to report changes in value on either the balance sheet or the income statement, because both are rigorously reviewed. They also expressed concern that, because certain items of other comprehensive income generally appear on the balance sheet and not on the income statement, the methodology used by many taxpayers for financial reporting would fail to be an eligible method and, therefore, would not satisfy the safe harbor.

When changes in value appear on the income statement, they also appear in retained earnings and in earnings-per-share. This creates a tension between the benefits of higher earnings for financial reporting and the benefit of lower income for tax reporting. This tension helps to ensure the reliability of values for tax purposes, a fundamental concept underlying the safe harbor. Balance sheet items, such as other comprehensive income, do not have the same tension. Therefore, the final regulations retain the income statement requirement of the NPRM.

Bid-Ask Limitation

Some commentators suggested that the bid-ask limitation be eliminated to make it easier for taxpayers to qualify for the safe harbor. These commentators indicated that dealers generally do not retain records of individual positions' bid-ask spreads for any meaningful period of time, and it would be burdensome to monitor the spreads of those positions for which records do exist.

The safe harbor set forth in the NPRM does not add to taxpayers' existing recordkeeping burden. Without the safe harbor, other sections of the Code would require taxpayers to keep records to prove the values of individual positions or to keep records of spreads if taxpayers account for their income and loss based on those spreads. The safe harbor simply allows taxpayers to use those same records to prepare both the applicable financial statement and their tax return. Accordingly, the bid-ask limitation has been retained in the final regulations.

Additionally, according to some commentators, the requirement in the NPRM that values should be nearer to the mid-market value than to the bid or ask value could be interpreted in two ways. First, it could be a requirement that, if not met for a particular position, would disqualify an entire financial accounting method as an eligible method. Second, it could be a safe harbor that, if not met for a particular position, would not disqualify the method

but would require the taxpayer to prove that the method consistently produces values nearer to mid-market than to bid or ask. The final regulations make it clear that this provision is a safe harbor and that a method that may occasionally produce a value that is not nearer to mid-market than to bid or ask will not preclude use of the safe harbor.

The Treasury Department and the IRS also received suggestions from commentators seeking expansion of the exceptions to the bid-ask limitations. Some commentators noted that the exception for exchange-traded positions in the NPRM was too narrow because it did not cover those equities and debt securities, such as Treasury obligations, that are traded in very liquid, over-the-counter markets and have easily determinable values. These commentators suggested that, rather than limit the exception to positions on qualified boards or exchanges as defined in section 1256(g)(7), the regulations should include within the exception all positions for which there is an established financial market within the meaning of §1.1092(d)–1(b).

The exception for positions that are traded on a qualified board or exchange described in section 1256(g)(7) was included in the NPRM to except those positions with spreads so small that applying the bid-ask limitation would have little effect on the determination of fair market value. Because section 1092 is an anti-abuse provision that Congress intended to be broad in scope, the definition of established financial market in §1.1092(d)–1(b) reflects a corresponding breadth. Thus, expansion of the exception for exchange-traded positions by reference to §1.1092(d)–1(b) might inappropriately except too many positions from the general bid-ask limitation. For example, many derivative contracts for which dealers lock in spreads are positions for which there is an established financial market. See §1.1092(d)–1(b), (c). Consequently, the reference to section 1256(g)(7) has been retained.

Some of the comments about the bid-ask exception were prompted by the view that debt instruments should be excepted from the bid-ask limitation for some of the same reasons as positions traded on a 1256(g)(7) board or exchange.

The Treasury Department and the IRS, however, decline at this time to adopt the suggestion that debt instruments be generally excepted from the bid-ask limitation. The Treasury Department and the IRS recognize that dealers' business model for debt instruments generally is to turn over debt securities very rapidly and that dealers have a strong economic incentive to do so because holding debt securities consumes balance sheet resources and poses risk management issues. Nevertheless, based on comments received, the Treasury Department and the IRS do not possess sufficient information to conclude that spreads in the over-the-counter debt markets are *de minimis*. Additionally, debt instruments may be used to lock in spreads with respect to open positions in other instruments, such as derivatives. Therefore, excepting over-the-counter debt instruments from the bid-ask limitation may be contrary to the tenets of the dealer business model for derivatives. Moreover, excepting debt instruments from the bid-ask limitation might introduce a tax-motivated distortion into the marketplace, as taxpayers may decide to lock in spreads with tax-advantaged instruments rather than with instruments that are selected on the basis of their non-tax economic attributes. The Commissioner may, however, designate additional positions as being exempt from the bid-ask limitation.

Understanding the need for a limitation on the use of bid and ask values, one commentator suggested an open position exception to the bid-ask limitation. Under this alternative, offsetting positions in the balanced portion of a portfolio would not be valued at or near the bid or ask values. Open positions, however, would not be subject to this limitation. Instead, they could be valued at any value between and including the bid and ask values. According to this commentator, the bid-ask limitation ensures that the present value of the income attributable to the bid-ask spread is recognized in the taxable year the synthetic annuity is created. Open positions, it was noted, do not create a synthetic annuity so the bid-ask limitation need not apply to them.

The Treasury Department and the IRS decline to adopt the rule suggested by this commentator. Under a mark-to-market system, when a dealer enters into an open position with a customer, that dealer has captured the spread inherent in that customer position, even if the customer position is not offset by another position. Although it can be argued that a dealer may be forced to pay a spread to obtain a position offsetting the open customer position, to assume a dealer would do so across the board would be to ascribe customer status (which is paying spreads) to the dealer, a result inconsistent with the dealer business model (which is charging spreads). Additionally, in the event a dealer actually pays a spread to offset the open customer position, the disadvantageous terms of the offsetting position will be reflected in the mark-to-market valuation of that position. Administrability is also a concern. Before accepting the suggestion that a dealer should recognize no mark-to-market income from any open position until the position is offset by one or more other positions, the Treasury Department and the IRS would need more information regarding the manner in which to verify the process for determining the proper amounts of adjustments taxpayers will use to achieve this result.

Eligible Methods, Eligible Positions and the Safe Harbor Election

The final regulations modify the NPRM by providing that the election to use the safe harbor is made by filing a statement with the taxpayer's return declaring that the taxpayer makes the safe harbor election for all eligible positions for which it has an eligible method. An example elaborating on this concept has been added to the final regulations.

Applicable Financial Statements

Not all financial statements qualify under the safe harbor. Consequently, these regulations set forth a system that enables a taxpayer to determine which one of its financial statements, if any, may be used when applying the safe harbor. The final regulations adopt the provisions of the NPRM on applicable financial statements.

Some commentators expressed concern that U.S. branches of foreign banks would not be eligible to use the safe harbor because they do not prepare financial statements in accordance with U.S. GAAP. The comments suggested that many of these branches prepare their financial statements in accordance with rules that are substantially similar to U.S. GAAP and, therefore, should be permitted to use those non-U.S. GAAP financial statements for purposes of the safe harbor. The commentators also

suggested that call reports submitted to U.S. bank regulators by foreign banks have sufficient *indicia* of reliability to merit use in the safe harbor, even though changes over time in the values in those reports may not be directly reflected in income statements prepared according to U.S. GAAP.

As noted in this preamble, the safe harbor is based on the concept that, with appropriate limitations, mark-to-market values used on certain financial statements can be sufficiently consistent with fair market values under section 475. The IRS and Treasury Department have concluded that the requirements and limitations of the safe harbor ensure sufficient consistency when applied to financial statements prepared according to U.S. GAAP. This conclusion is less clear when the requirements and limitations are applied to financial statements prepared under other accounting regimes. Consequently, the final regulations retain the requirement that applicable financial statements be prepared in accordance with U.S. GAAP. The final regulations retain the requirement in the NPRM that, to be an eligible method, a financial statement method of accounting must cause changes in value to be recognized into income on the income statement.

Nevertheless, making it practical for foreign banks to use the safe harbor for their U.S. branches could be valuable not only to the foreign banks but also to the IRS in its administration and application of section 475. Therefore, the IRS and Treasury Department are interested in expanding the scope of these regulations so that they may apply in the future to foreign banks. Answers to the following questions would facilitate efforts to achieve that expansion. First, should the safe harbor require that the values reported in the call report of the foreign bank be the same values that are reported in the income statement filed in the foreign bank's home country? If so, should the foreign bank, together with its certified independent registered public accountant, file with the U.S. tax return, subject to penalties of perjury, a statement to that effect?

Second, should the valuation standards used in the foreign bank's home country be identical to the valuation standards under U.S. GAAP, and if not identical, in what ways may they differ? If so, should the foreign bank, together with its certified independent registered public accountant, file a statement with the U.S. tax return, subject to penalties of perjury, describing the differences, if any, between the foreign country valuation standards and those under U.S. GAAP? Further, should the foreign valuation standards be fully consistent with, and should the foreign country have formally adopted, International Financial Reporting Standards as published by the International Accounting Standards Board?

Third, should the income statement filed by the foreign bank be filed with the foreign bank's home country bank regulator (as distinct from a market regulator like the SEC)?

Fourth, for purposes of these questions, should the term "home country" mean the country in which the foreign bank is chartered or incorporated?

Record Retention and Production

The safe harbor will be administrable only if the IRS can readily verify that the financial statements at issue are taxpayers' applicable financial statements, that the accounting methods used are eligible methods, and that the values used on the applicable financial statements are also used on the Federal income tax return. Consequently, recordkeeping and record production are critical to the effective administration of the safe harbor.

These final regulations retain the provisions of the NPRM regarding record retention and production. They provide specific requirements for the types of records that must be maintained and provided, to enable ready verification. In general, electing taxpayers must clearly show: (1) that the same value used for financial reporting was used on the Federal income tax return; (2) that no eligible position subject to section 475 is excluded from the application of the safe harbor; and (3) that only eligible positions subject to section 475 are carried over to the Federal income tax return under the safe harbor.

Commentators expressed concern that the language of the NPRM requiring all schedules, exhibits, computer programs, and other information used to produce values was too broad, making it difficult to know what materials must be retained and produced. They also expressed concern that a requirement to keep computer programs and information used in producing values not only would require taxpayers to keep information about models that are changed frequently but also would encourage IRS employees to examine valuation models not just for compliance with the definition of "eligible method" but also for examining the accuracy of the underlying valuations.

The final regulations retain the record retention and production requirements set forth in the NPRM. Other sections of the Code already require taxpayers to maintain records sufficient to support the accuracy of items reported on their Federal tax returns. Except for a possible increase in the retention period in some instances, therefore, the final regulations create no additional burden. To avoid confusion or undue burden, the final regulations permit a taxpayer to enter into an agreement with the IRS specifying which records must be maintained, how they must be maintained, and for how long they must be maintained. These agreements may include terms covering the maintenance of computer programs and information used in producing values.

The maintenance and production requirements of the regulations preclude undue delay in producing records. One commentator suggested that the 30-day deadline provided too little time to produce records. During the development of these regulations, the IRS conducted a test program to determine not only whether values could be traced from financial statements to the tax return but also how long it would take for taxpayers to produce the necessary records. This test program demonstrated that 30 days was generally a sufficient period of time. For specific cases, the Commissioner may excuse failures to provide records within 30 days if the taxpayer shows reasonable cause for the failure and has made a good faith effort to comply. As noted above, the taxpayer may also enter into an agreement with the Commissioner that sets forth a different time period. Accordingly, the final regulations retain the general 30-day requirement.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order

12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the expectation that the safe harbor will be used primarily by dealers in securities that are financial institutions with a sophisticated understanding of the capital markets. Because section 475 is elective for dealers in commodities, some small businesses could qualify for the safe harbor if they make two voluntary elections: (1) an election to mark to market commodities under section 475 and (2) an election to apply the safe harbor. Because both elections are voluntary, it is unlikely any small business taxpayer who thinks the reporting and recordkeeping requirements are too burdensome will make these elections. Furthermore, the total average estimated burden per taxpayer is small, as reported earlier in the preamble. This is because most of the recordkeeping requirements do not require taxpayers to generate new records, but instead require records used for financial reporting purposes to be kept for tax reporting purposes. For all of these reasons, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Marsha A. Sabin and John W. Rogers III, Office of the Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 ***

Section 1.475(a)–4 also issued under 26 U.S.C. 475(g). * * *

Par. 2. Section 1.475–0 is amended by:

1. Revising the introductory text.

2. Adding entries to the table for §1.475(a)–4.

3. Redesignating the entry for §1.475(e)–1 as §1.475(g)–1.

The revision and addition reads as follows:

§1.475–0 Table of contents.

This section lists the major captions in §§1.475(a)–3, 1.475(a)–4, 1.475(b)–1, 1.475(b)–2, 1.475(b)–4, 1.475(c)–1, 1.475(c)–2, 1.475(d)–1 and 1.475(g)–1.

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§1.475(a)–4 Safe harbor for valuation under section 475.

(a) Overview.
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(2) Dealer business model.
(3) Summary of paragraphs.
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(1) General rule.
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(c) Eligible taxpayer.
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(i) Frequency.
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(i) Bid-ask method.
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(B) Safe harbor.
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(f) Election.
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(i) [Reserved.]
(j) Significant business use.
(1) In general.
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(3) Management of a business as a dealer.
(4) Significant use.
(k) Retention and production of records.
(1) In general.
(2) Specific requirements.
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(A) In general.
(B) Values on books and records with supporting schedules.
(C) Consolidation schedules.
(ii) Instructions provided by the Commissioner.
(3) Time for producing records.
(4) Retention period for records.
(5) Agreements with the Commissioner.
(l) [Reserved.]
(m) Use of different values.

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§1.475(g)–1 Effective dates.

Par. 3. Section 1.475(a)–4 is added to read as follows:

§1.475(a)–4 Valuation safe harbor.

(a) *Overview*—(1) *Purpose*. This section sets forth a safe harbor that, under certain circumstances, permits taxpayers to

elect to use the values of positions reported on certain financial statements as the fair market values of those positions for purposes of section 475. This safe harbor is based on the principle that, if a mark-to-market method used for financial reporting is sufficiently consistent with the requirements of section 475 and if the financial statement employing that method has certain *indicia* of reliability, then the values used on that financial statement may be used for purposes of section 475. If other provisions of the Internal Revenue Code or regulations require adjustments to fair market value, use of the safe harbor does not eliminate the need for those adjustments. See paragraph (e) of this section.

(2) *Dealer business model.* The safe harbor is based on the business model for a derivatives dealer. Under this model, the dealer seeks to capture and profit from bid-ask spreads in the marketplace by entering into substantially offsetting positions with customers that will remain on the derivatives dealer's books over their terms. Because the positions in the aggregate tend to offset each other, the dealer has achieved a predictable net cash flow (for example, a synthetic annuity) that reflects the captured bid-ask spread. This net cash flow is generally impervious to market fluctuations in the values on which the component derivatives are based. Section 475 requires current recognition of the present value of the net cash flow attributable to the capture of these spreads.

(3) *Summary of paragraphs.* Paragraph (b) of this section sets forth the safe harbor. To determine who may use the safe harbor, paragraph (c) of this section defines the term "eligible taxpayer." Paragraph (d) of this section sets forth the basic requirements for determining whether the method used for financial reporting is sufficiently consistent with the requirements of section 475. Paragraph (e) of this section describes adjustments to the financial statement values that may be required for purposes of applying this safe harbor. Paragraph (f) of this section describes the procedure for making the safe harbor election and the conditions under which the election may be revoked. Paragraph (g) of this section provides that the Commissioner will issue a revenue procedure that lists the types of securities and commodities that are eligible positions for purposes of the safe harbor. Using rules for determining priorities among financial statements, paragraph (h) of this section defines the term "applicable financial statement" and so describes the financial statement, if any, whose values may be used in the safe harbor. In some cases, as required by paragraph (j) of this section, the safe harbor is available only if the taxpayer's operations make significant business use of financial statement values. Paragraph (k) of this section sets forth requirements for record retention and record production. Paragraph (m) of this section provides that the Commissioner may use fair market values that clearly reflect income, but which differ from values used on the applicable financial statement, if an electing taxpayer fails to comply with the recordkeeping and record production requirements of paragraph (k) of this section.

(b) *Safe harbor*—(1) *General rule.* Subject to any adjustment required by paragraph (e) of this section, if an eligible taxpayer uses an eligible method for the valuation of an eligible position on its applicable financial statement and the eligible taxpayer is subject to the election described in paragraph (f) of this section, the value that the eligible taxpayer assigns to that eligible position on its applicable financial statement is the fair market value of the eligible position for purposes of section 475 and must be used for purposes of section 475, even if that value is not the fair market value of the position for any other purpose of the internal revenue laws. Notwithstanding the rule set forth in this paragraph, the Commissioner may, in certain circumstances, use fair market values that clearly reflect income but differ from the values used on the applicable financial statement. See paragraph (m) of this section.

(2) *Example. Use of eligible and non-eligible methods.* X uses eligible methods on its applicable financial statement for some, but not all, securities and commodities that are eligible positions. When X elects into the safe harbor, the election applies to all eligible positions for which X has an eligible method. Therefore, once the election is in effect, the financial statement values for eligible positions for which X has an eligible method are the fair market values of those eligible positions for purposes of section 475. Since X, however, does not have an eligible method for all eligible positions, those eligible positions for which X does not have an eligible method remain subject to the fair market value requirements of section 475 as set out in case law and otherwise.

(3) *Scope of the safe harbor.* The safe harbor may be used only to determine values for eligible positions that are properly marked to market under section 475. It does not determine whether any positions may or may not be subject to mark-to-market accounting under section 475.

(c) *Eligible taxpayer.* An eligible taxpayer is —

(1) A dealer in securities, as defined in section 475(c)(1); or

(2) A dealer in commodities, as defined in section 475(e), that is subject to an election under section 475(e).

(d) *Eligible method*—(1) *Sufficient consistency.* An eligible method is a mark-to-market method that is sufficiently consistent with the requirements of a mark-to-market method under section 475. To be sufficiently consistent with the requirements of a mark-to-market method under section 475, the eligible method must satisfy all of the requirements of paragraph (d)(2) and paragraph (d)(3) of this section.

(2) *General requirements.* The method—

(i) *Frequency.* Must require a valuation of the eligible position no less frequently than annually, including a valuation as of the last business day of the taxable year;

(ii) *Recognition at the mark.* Must recognize into income on the income statement for each taxable year mark-to-market gain or loss based upon the valuation or valuations described in paragraph (d)(2)(i) of this section;

(iii) *Recognition on disposition.* Must require, on disposition of the eligible position, recognition into income (on the income statement for the taxable year of disposition) as if a year-end mark occurred immediately before such disposition; and

(iv) *Fair value standard.* Must require use of a valuation standard that arrives at fair value in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP).

(3) *Limitations*—(i) *Bid-ask method*—(A) *General rule.* Except for eligible positions that are traded on a qualified board or exchange, as defined in section 1256(g)(7), or eligible positions that the Commissioner designates in a revenue procedure or other published guidance, the valuation standard used must not, other than on a *de minimis* portion of a taxpayer's positions, permit

values at or near the bid or ask value. Consequently, the valuation method described in §1.471–4(a)(1) fails to satisfy this paragraph (d)(3)(i)(A).

(B) *Safe harbor.* The restriction in paragraph (d)(3)(i)(A) of this section is satisfied if the method consistently produces values that are closer to the mid-market values than they are to the bid or ask values.

(ii) *Valuations based on present values of projected cash flows.* If the method of valuation consists of projecting cash flows from an eligible position or positions and determining the present value of those cash flows, the method must not take into account any cash flows attributable to a period or time on or before the valuation date. In addition, adjustment of the gain or loss recognized on the mark may be required with respect to payments that will be made after the valuation date to the extent that portions of the payments have been recognized for tax purposes before the valuation and appropriate adjustment has not been made for purposes of determining financial statement value.

(iii) *Accounting for costs and risks.* Valuations may account for appropriate costs and risks, but no cost or risk may be accounted for more than once, either directly or indirectly. Further, no valuation adjustment for any cost or risk may be made for purposes of this safe harbor if that valuation adjustment is not also permitted by, and taken for, U.S. GAAP purposes on the taxpayer's applicable financial statement. If appropriate, the costs and risks that may be accounted for include, but are not limited to, credit risk (appropriately adjusted for any credit enhancement), future administrative costs, and model risk. An adjustment for credit risk is implicit in computing the present value of cash flows using a discount rate greater than a risk-free rate. Accordingly, a determination of whether any further downward adjustment to value for credit risk is warranted, or whether an upward adjustment is required, must take that implicit adjustment into consideration.

(4) *Examples.* The following examples illustrate this paragraph (d):

Example 1. (i) X, a calendar year taxpayer, is a dealer in securities within the meaning of section 475(c)(1). X generally maintains a balanced portfolio of interest rate swaps and other interest rate derivatives, capturing bid-ask spreads and keeping its market exposure within desired limits (using, if necessary, additional derivatives for this purpose). X uses a mark-to-market method on a statement that it is required to file with the United States Securities and Exchange Commission (SEC) and that satisfies paragraph (d)(2) of this section with respect to both the contracts with customers and the additional derivatives. When determining the amount of any gain or loss realized on a sale, exchange, or termination of a position, X makes a proper adjustment for amounts taken into account respecting payments or receipts. All of X's counterparties on the derivatives have credit ratings of AA/aa, according to standard credit ratings obtained from private credit rating agencies.

(ii) Under X's valuation method, as of each valuation date, X determines a mid-market probability distribution of future cash flows under the derivatives and computes the present values of these cash flows. In computing these present values, X uses an industry standard yield curve that is appropriate for obligations by persons with credit ratings of AA/aa. In addition, based on information that includes its own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from AA/aa.

(iii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

Example 2. (i) The facts are the same as in *Example 1*, except that X uses a AAA/aaa rate to discount the payments to be received under the derivatives. Based on information that includes its own knowledge about the counterparties, X adjusts these present values to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from a AAA/aaa obligation.

(ii) X's methodology does not violate the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once.

Example 3. (i) The facts are the same as in *Example 1*, except that, after computing present values using the discount rates that are appropriate for obligors with credit ratings of AA/aa, and based on information that includes X's own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from AAA/aaa.

(ii) X's methodology violates the requirement in paragraph (d)(3)(iii) of this section that the same cost or risk not be taken into account, directly or indirectly, more than once. By using a AA/aa discount rate, X's method takes into account the difference between risk-free obligations and AA/aa obligations. This difference includes the difference between a rating of AAA/aaa and one of AA/aa. By adjusting values for the difference between a rating of AAA/aaa and one of AA/aa, X takes into account risks that it had already accounted for through the discount rates that it used. The same result would occur if X judged some of its counterparties' obligations to be of AAA/aaa quality but X failed to adjust the values of those obligations to reflect the difference between a rating of AAA/aaa and one of AA/aa.

Example 4. (i) The facts are the same as in *Example 1*, except that X determines the mid-market value for each derivative and then subtracts the corresponding part of the bid-ask spread.

(ii) X's methodology violates the rule in paragraph (d)(3)(i) of this section that forbids valuing positions at or near the bid or ask value.

Example 5. (i) The facts are the same as in *Example 1*, and, in addition, X's adjustments for all risks and costs, including credit risk, future administrative costs and model risk, may occasionally cause the adjusted value of an eligible position to be at or near the bid value or ask value.

(ii) X's methodology does not violate the rule in paragraph (d)(3)(i)(A) of this section that forbids valuing eligible positions at or near the bid or ask value.

(e) *Compliance with other rules.* Notwithstanding any other provisions of this section, the fair market values for purposes of the safe harbor must be consistent with section 482, or rules that adopt section 482 principles, when applicable. For example, if a notional principal contract is subject to section 482 or section 482 principles, the values of future cash flows taken into account in determining the value of the contract for purposes of section 475 must be consistent with section 482.

(f) *Election*—(1) *Making the election.* Unless the Commissioner prescribes otherwise, an eligible taxpayer elects under this section by filing with the Commissioner a statement declaring that the taxpayer makes the safe harbor election in this section for all eligible positions for which it has an eligible method. In addition to any other information that the Commissioner may require, the statement must describe the taxpayer's applicable financial statement for the first taxable year for which the election is effective and must state that the taxpayer agrees to provide upon the request of the Commissioner all information, records, and schedules in the manner required by paragraph (k) of this section. The statement must be attached to a timely filed Federal income tax return (including extensions) for the taxable year for which the election is first effective.

(2) *Duration of the election.* Once made, the election continues in effect for all subsequent taxable years unless revoked.

(3) *Revocation*—(i) *By the taxpayer.* An eligible taxpayer that is subject to an election under this section may revoke the

election only with the consent of the Commissioner.

(ii) *By the Commissioner.* The Commissioner, after consideration of the relevant facts and circumstances, may revoke an election under this section, effective beginning with the first open year for which the election is effective or with any subsequent year, if—

(A) The taxpayer fails to comply with paragraph (k) of this section (concerning record retention and production) and the taxpayer does not show reasonable cause for this failure;

(B) The taxpayer ceases to have an applicable financial statement or ceases to use an eligible method; or

(C) For any other reason, no more than a *de minimis* number of eligible positions, or no more than a *de minimis* fraction of the taxpayer's eligible positions, are covered by the safe harbor in paragraph (b) of this section.

(4) *Re-election.* If an election is revoked, either by the Commissioner or by the taxpayer, the taxpayer (or any successor in interest of the taxpayer) may not make the election without the consent of the Commissioner for any taxable year that begins before the date that is six years after the first day of the earliest taxable year affected by the revocation.

(g) *Eligible positions.* For any taxpayer, an eligible position is any security or commodity that the Commissioner in a revenue procedure or other published guidance designates as an eligible position with respect to that taxpayer for purposes of this safe harbor.

(h) *Applicable financial statement*—(1) *Definition.* An eligible taxpayer's applicable financial statement for a taxable year is the taxpayer's primary financial statement for that year if that primary financial statement is described in paragraph (h)(2)(i) of this section (concerning statements required to be filed with the SEC) or if that primary financial statement both meets the requirements of paragraph (j) of this section (concerning significant business use) and is described in either paragraph (h)(2)(ii) or (iii) of this section. Otherwise, or if the taxpayer does not have a primary financial statement for the taxable year, the taxpayer does not have an applicable financial statement for the taxable year.

(2) *Primary financial statement.* For any taxable year, an eligible taxpayer's primary financial statement is the financial statement, if any, described in one or more of paragraphs (h)(2)(i), (ii), and (iii) of this section. If more than one financial statement of the taxpayer for the year is so described, the primary financial statement is the one first described in paragraphs (h)(2)(i), (ii), and (iii) of this section. A taxpayer has only one primary financial statement for any taxable year.

(i) *Statement required to be filed with the Securities and Exchange Commission (SEC).* A financial statement that is prepared in accordance with U.S. GAAP and that is required to be filed with the SEC, such as the 10-K or the Annual Statement to Shareholders.

(ii) *Statement filed with a Federal agency other than the Internal Revenue Service.* A financial statement that is prepared in accordance with U.S. GAAP and that is required to be provided to the Federal government or any of its agencies other than the Internal Revenue Service (IRS).

(iii) *Certified audited financial statement.* A certified audited financial statement that is prepared in accordance with U.S. GAAP; that is given to creditors for purposes of making lending decisions, given to equity holders for purposes of evaluating their investment in the eligible taxpayer, or provided for other substantial non-tax purposes; and that the taxpayer reasonably anticipates will be directly relied on for the purposes for which it was given or provided.

(3) *Example. Primary financial statement.* X prepares financial statement FS1, which is required to be filed with a Federal government agency other than the SEC or the IRS. FS1 is thus described in paragraph (h)(2)(ii) of this section. X also prepares financial statement FS2, which is a certified audited financial statement that is given to creditors and that X reasonably anticipates will be relied on for purposes of making lending decisions. FS2 is thus described in paragraph (h)(2)(iii) of this section. Because FS1, which is described in paragraph (h)(2)(ii) of this section, is described before FS2, which is described in paragraph (h)(2)(iii) of this section, FS1 is X's primary financial statement.

(4) *Financial statements of equal priority.* If the rules of paragraph (h)(2) of this section cause two or more financial statements to be of equal priority, then the statement that results in the highest aggregate valuation of eligible positions being marked to market under section 475 is the primary financial statement.

(5) *Consolidated groups.* If the taxpayer is a member of an affiliated group that files a consolidated return, the primary financial statement of the taxpayer is the primary financial statement, if any, of the common parent (within the meaning of section 1504(a)(1)) of the consolidated group.

(6) *Supplement or amendment to a financial statement.* A financial statement includes any supplement or amendment to the financial statement.

(7) *Certified audited financial statement.* For purposes of this paragraph (h), a financial statement is a certified audited financial statement if it is certified by an independent certified public accountant from a Registered Public Accounting firm, as defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002, Public Law 107–204, 116 Stat. 746 (July 30, 2002), 15 U.S.C. §7201(a)(12), and rules promulgated under that Act, and is—

(i) Certified to be fairly presented (a "clean" opinion);

(ii) Certified to be fairly presented subject to a concern about a contingency, other than a contingency relating to the value of eligible positions (a qualified "subject to" opinion); or

(iii) Certified to be fairly presented except for a method of accounting with which the Certified Public Accountant disagrees and which is not a method used to determine the value of an eligible position held by the eligible taxpayer (a qualified "except for" opinion).

(i) [Reserved].

(j) *Significant business use*—(1) *In general.* A financial statement is described in this paragraph (j) if—

(i) The financial statement contains values for eligible positions;

(ii) The eligible taxpayer makes significant use of financial statement values in most of the significant management functions of its business; and

(iii) That use is related to the management of all or substantially all of the eligible taxpayer's business.

(2) *Financial statement value.* For purposes of this paragraph (j), the term *financial statement value* means—

(i) A value that is taken from the financial statement; or

(ii) A value that is produced by a process that is in all respects identical to the process that produces the values that appear on the financial statement but that is not taken from the statement because either—

(A) The value was determined as of a date for which the financial statement does not value eligible positions; or

(B) The value is used in the management of the business before the financial statement has been prepared.

(3) *Management functions of a business.* For purposes of this paragraph (j), the term *management functions of a business* refers to the financial and commercial oversight of the business. Oversight includes, but is not limited to, senior management review of business-unit profitability, market risk measurement or management, credit risk measurement or management, internal allocation of capital, and compensation of personnel. Management functions of a business do not include either tax accounting or reporting the results of operations to persons other than directors or employees.

(4) *Significant use.* If an eligible taxpayer uses financial statement values for some significant management functions and uses values that are not financial statement values for other significant management functions, then the determination of whether the taxpayer has made significant use of the financial statement values is made on the basis of all the facts and circumstances. This determination must particularly take into account whether the taxpayer's reliance on the financial statement values exposes the taxpayer to material adverse economic consequences if the values are incorrect.

(k) *Retention and production of records*—(1) *In general.* In addition to all records that section 6001 otherwise requires to be retained, an eligible taxpayer subject to the election provided by this section must keep, and timely provide to the Commissioner upon request, records and books of account that are sufficient to establish that the financial statement to which the income tax return conforms is the taxpayer's applicable financial statement, that the method used on that statement is an eligible method, and that the values used for eligible positions for purposes of section 475 are the values used in the applicable financial statement. This obligation extends to all records and books that are required to be maintained for any period for financial or regulatory reporting purposes, even if these records or books may not otherwise be specifically covered by section 6001. All records and books described in this paragraph (k) must be maintained for the period described in paragraph (k)(4) of this section, even if a lesser period of retention applies for financial statement or regulatory purposes.

(2) *Specific requirements*—(i) Verification and *reconciliation.* Unless the Commissioner otherwise provides—

(A) *In general.* An eligible taxpayer must provide books and records to verify the appropriate use of the safe harbor and reconciliation schedules between the applicable financial statement for the taxable year and the Federal income tax return for that year. The required verification materials and reconciliation schedules include all supporting schedules, exhibits, computer programs, and any other information used in producing the values and schedules, including the documentation of rules and procedures governing determination of the values. The required reconciliation schedules must also include a detailed explanation of any adjustments necessitated by the imperfect overlap between the eligible positions that the taxpayer marks to market under section 475 and the eligible positions for which the applicable financial statement uses an eligible method. In the time and manner provided by the Commissioner, a corporate taxpayer subject to this paragraph (k) must reconcile the net income amount reported on its applicable financial statement to the amount reported on the applicable forms and schedules on its Federal income tax return (such as the Schedule M–1, "*Reconciliation of Income (Loss) per Books With Income per Return*"; Schedule M–3, "*Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More*"; and Form 1120F, "*U.S. Income Tax Return of a Foreign Corporation*"). Eligible taxpayers that are not otherwise required to file a Schedule M–1 or Schedule M–3 must reconcile net income using substitute schedules similar to Schedule M–1 and Schedule M–3, and these substitute schedules must be attached to the return.

(B) *Values on books and records with supporting schedules.* The books and records must state the value used for each eligible position separately from the value used for any other eligible position. However, an eligible taxpayer may make adjustments to values on a pooled basis, if the taxpayer demonstrates that it can compute gain or loss attributable to the sale or other disposition of an individual eligible position.

(C) *Consolidation schedules.* An eligible taxpayer must provide a schedule showing the consolidation and de-consolidation that is used in preparing the applicable financial statement, along with exhibits and subordinate schedules. This schedule must provide information that addresses the differences for consolidation and de-consolidation between the applicable financial statement and the Federal income tax return.

(ii) *Instructions provided by the Commissioner.* The Commissioner may provide an alternative time or manner in which an eligible taxpayer subject to this paragraph (k) must establish that the same values used for eligible positions on the applicable financial statement are also the values used for purposes of section 475 on the Federal income tax return.

(3) *Time for producing records.* All documents described in this paragraph (k) must be produced within 30 days of a request by the Commissioner, unless the Commissioner grants a written extension. Generally, the Commissioner will exercise his discretion to excuse a minor or inadvertent failure to provide requested documents if the taxpayer shows reasonable cause for the failure, has made a good faith effort to comply with the requirement to produce records, and promptly remedies the failure. For failures to maintain, or timely produce, records, see paragraph (f)(3)(ii) of this section (allowing the Commissioner to revoke the election), and see paragraph (m) of this section (allowing the Commissioner, but not the taxpayer, to use for eligible positions that otherwise might be subject to the safe harbor fair market values that clearly reflect income but that are different from the values used on the applicable financial statement).

(4) *Retention period for records.* All materials required by this paragraph (k) and section 6001 must be retained as long as their contents may become material in the administration of any internal revenue law.

(5) *Agreements with the Commissioner.* The Commissioner and an eligible taxpayer may enter into a written agreement that establishes, for purposes of this paragraph (k), which records must be maintained, how they must be maintained, and for how long they must be maintained.

(l) [Reserved].

(m) *Use of different values.* If, with respect to the records that relate to certain eligible positions for a taxable year, the taxpayer fails to satisfy paragraph (k) of this section (concerning record retention and record production), then, for those eligible positions for that year, the Commissioner may use values that the Commissioner determines to be fair market values that are appropriate to clearly reflect income, even if the values so determined are different from the values reported for those positions on the applicable financial statement. See also paragraph (f)(3)(ii) of this section (concerning revocation of the election by the Commissioner when a taxpayer does not produce required records and fails to demonstrate reasonable cause for the failure).

§1.475(e)–1 [Redesignated as §1.475(g)–1]

Par. 4. Section 1.475(e)–1 is redesignated as §1.475(g)–1.

Par. 5. Newly designated §1.475(g)–1 is amended by redesignating paragraphs (d) through (j) as paragraphs (e) through (k), respectively, and adding a new paragraph (d) to read as follows:

§1.475(g)–1 Effective dates.

* * * * *

(d) Section 1.475(a)–4 (concerning a safe harbor to use applicable financial statement values for purposes of section 475) applies to taxable years ending on or after June 12, 2007.

* * * * *

PART 602 – OMB CONTROL NUMBERS UNDER PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 USC 7805

Par. 7. In §602.101, paragraph (b) is amended by adding the entry for 1.475(a)–4 to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.475(a)–4	1545–1945
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved May 30, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 11, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 12, 2007, 72 F.R. 32172)

Section 482.—Allocation of Income and Deductions Among Taxpayers

Must the fair market values for purposes of the safe harbor be consistent with section 482, if a taxpayer is subject to section 482. See T.D. 9328, page 1.

Section 892.—Income of Foreign Governments and of International Organizations

A notice alerts taxpayers and their representatives that the IRS intends to challenge claims under the relevant current statutory and regulatory provisions that certain distributions, described in the notice, from a real estate investment trust (REIT) or other qualified investment entity (QIE) to foreign governments are not subject to section 897(h)(1) of the Internal Revenue Code or are exempt from taxation under section 892 of the Code. The notice also announces that Treasury and the IRS intend to issue regulations that will clarify the correct interpretation of these provisions. See Notice 2007-55, page 13.

Section 897.—Disposition of Investment in United States Real Property

A notice alerts taxpayers and their representatives that the IRS intends to challenge claims under the relevant current statutory and regulatory provisions that certain distributions, described in the notice, from a real estate investment trust (REIT) or other qualified investment entity (QIE) to foreign governments are not subject to section 897(h)(1) of the Internal Revenue Code or are exempt from taxation under section 892 of the Code. The notice also announces that Treasury and the IRS intend to issue regulations that will clarify the correct interpretation of these provisions. See Notice 2007-55, page 13.

Section 1256.—Section 1256 Contracts Marked to Market

If a dealer has eligible positions that trade on a qualified board or exchange, are they permitted to report those positions' values at or near the bid or ask value. See T.D. 9328, page 1.

Part III. Administrative, Procedural, and Miscellaneous

Preparer Penalty Provisions Under the Small Business and Work Opportunity Act of 2007

Notice 2007–54

This notice provides guidance and transitional relief for the return preparer penalty provisions under section 6694 of the Internal Revenue Code, as amended by the Small Business and Work Opportunity Act of 2007.

SCOPE

The transitional relief provided by this notice will apply to all returns, amended returns, and refund claims due on or before December 31, 2007 (determined with regard to any extension of time for filing); to 2007 estimated tax returns due on or before January 15, 2008; and to 2007 employment and excise tax returns due on or before January 31, 2008.

BACKGROUND

The Small Business and Work Opportunity Act of 2007, Pub. L. No. 110–28, 121 Stat. ___, (the Act) was enacted into law on May 25, 2007. Section 8246 of the Act amends several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the penalties for preparing a return which reflects an understatement of liability, and increase applicable penalties. The amendments are effective for tax returns prepared after the date of the enactment, May 25, 2007.

The amendments made by the Act raise questions regarding activities representing preparation of a tax return, who is a return preparer within the meaning of section 7701(a)(36) (as amended), and how the statute applies to signing and non-signing preparers. In order to address these questions, the Internal Revenue Service and the Treasury Department are considering whether regulations or other published guidance are needed, including but not limited to, amendments to Treas. Reg. sections 301.7701–15 and 1.6694–0 through 1.6694–4. Because the Act extends the types of returns subject to the new provisions, changes are also required to the relevant forms and publications. The Service must also alter existing procedures in order to process disclosures with certain forms and in electronic formats. Because the amendments to section 6694 are effective immediately for returns prepared after May 25, 2007, the Service and the Treasury Department believe that effective tax administration requires transitional relief with respect to the new standards of conduct under section 6694(a).

PENALTY UNDER SECTION 6694

Prior to amendment by the Act, the penalty under section 6694(a) applied if:

(1) any part of an understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,

(2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and,

(3) such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous.

Prior to amendment by the Act, the penalty under section 6694(b) applied if any part of an understatement was due to:

(1) a willful attempt in any manner by an income tax return preparer to understate the liability for tax; or

(2) to any reckless or intentional disregard of rules or regulations by an income tax return preparer.

Section 8246 of the Act amended several provisions of the Code to extend the scope of the income tax return preparer penalties to preparers of all tax returns, amended returns and claims for refund, including estate and gift tax returns, generation-skipping transfer tax returns, employment tax returns, and excise tax returns. The Act amended section 6694(a) to provide that the penalty would apply if:

(A) the tax return preparer knew (or reasonably should have known) of the position,

(B) there was not a reasonable belief that the position would more likely than not be sustained on its merits, and

(C)(i) the position was not disclosed as provided in section 6662(d)(2)(B)(ii), or

(ii) there was no reasonable basis for the position.

Although the Act did not alter the standard of conduct under section 6694(b), it increased the amount of the penalty and made the penalty applicable to all tax return preparers.

Section 8246 of the Act amends the standards of conduct under section 6694(a) in two ways. First, for undisclosed positions, the Act replaces the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits. Second, for disclosed positions, the Act replaces the not-frivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

The Act also increased the first-tier section 6694(a) penalty for understatements from \$250 to the greater of \$1000 or 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty was imposed. The Act increased the second-tier section 6694(b) penalty for willful or reckless conduct from \$1000 to the greater of \$5,000 or 50% of the income derived (or to be derived) by the tax return preparer.

Under both the prior and current law, disclosure under section 6694(a) is adequate if made on a Form 8275, *Disclosure Statement*, or Form 8275–R, *Regulation Disclosure Statement*, attached to the return, amended return, or refund claim, or pursuant to the annual revenue procedure authorized in Treasury Regulation sections 1.6694–2(c)(3) and 1.6662–4(f)(2). In addition, under both the prior and current law, the penalty under section 6694(a) would not be imposed if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

TRANSITIONAL RELIEF

In order to provide sufficient time to address issues pertaining to the implementation of the Act, the Service is providing the following transitional relief: For income tax returns, amended returns, and refund claims, the standards set forth under the previous law and current regulations under section 6694 will be applied in determining whether the Service will impose a penalty under section 6694(a). Generally, in applying transitional relief for income tax returns, amended returns or refund claims, disclosure would be adequate if made on a Form 8275, *Disclosure Statement*, or Form 8275–R, *Regulation Disclosure Statement*, attached to the return, amended return, or refund claim, or pursuant to the annual revenue procedure authorized in Treasury Regulation sections 1.6694–2(c)(3) and 1.6662–4(f)(2).

For all other returns, amended returns, and claims for refund, including estate, gift, and generation-skipping transfer tax returns, employment tax returns, and excise tax returns, the reasonable basis standard set forth in the regulations issued under section 6662, without regard to the disclosure requirements contained therein, will be applied in determining whether the Service will impose a penalty under section 6694(a).

This transitional relief will apply to all returns, amended returns, and refund claims due on or before December 31, 2007 (determined with regard to any extension of time for filing); to 2007 estimated tax returns due on or before January 15, 2008; and to 2007 employment and excise tax returns due on or before January 31, 2008.

No transitional relief is available under section 6694(b) as transitional relief is not appropriate for return preparers who exhibit willful or reckless conduct, regardless of the type of return prepared.

EFFECTIVE DATE

This notice is effective as of May 25, 2007.

CONTACT INFORMATION

The principal author of this notice is Michael E. Hara of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Mr. Hara at (202) 622–4910 (not a toll-free call).

Guidance to Clarify the Treatment of Certain Distributions Under Internal Revenue Code Section 897(h)(1)

Notice 2007–55

PURPOSE

The Treasury Department (Treasury) and Internal Revenue Service (IRS) are aware of a type of transaction, described below, in which a foreign government inappropriately claims that certain distributions from a real estate investment trust (REIT) or other qualified investment entity to the foreign government are not subject to section 897(h)(1) of the Internal Revenue Code (Code) or are exempt from taxation under section 892 of the Code. This notice alerts taxpayers and their representatives that the IRS intends to challenge such claims under the relevant current statutory and regulatory provisions. In addition, Treasury and the IRS intend to issue regulations that will clarify the correct interpretation of these provisions. These regulations will apply to distributions occurring on or after June 13, 2007.

TRANSACTIONS AT ISSUE

In a typical transaction, a foreign government purchases a non-controlling interest in a privately held (and domestically controlled) REIT, with a view to receiving dividends from the REIT over the course of the remaining life of the REIT (for example, five to seven years). At the end of the REIT's life, the REIT typically sells all or a portion of its assets and distributes the sales proceeds (and any remaining assets) to its shareholders in complete liquidation. In some cases, the liquidation may take place over more than one year.

Notwithstanding section 897(h)(1), the foreign government (or withholding agent) asserts that distributions from the REIT (including distributions in liquidation) that are attributable to gain from the sale or exchange of a United States real property interest (USRPI) described in section 897(c)(1)(A)(i) are exempt from taxation (and withholding) under section 892. The foreign government (or withholding agent) may also assert that section 897(h)(1) does not apply to liquidating distributions from the REIT.

BACKGROUND

Section 892 addresses the taxation of income of foreign governments. Section 892(a)(1) excludes from gross income and exempts from U.S. federal income tax certain categories of income earned by foreign governments, including dividends from and capital gains with respect to investments in the United States in stocks, bonds, or other domestic securities. Section 892(a)(2)(A) provides that the exclusion under section 892(a)(1) does not apply to income derived from the conduct of any commercial activity (whether within or without the United States), income received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or income derived from the disposition of any interest in a controlled commercial entity. In addition, income derived from sources other than described in section 892(a)(1) is not excluded from gross income and is not exempt from tax under section 892. See the flush language following Treas. Reg. § 1.892–3T(a)(1)(iii). Under section 892(a)(3), a foreign government is treated as a corporate resident of its country for purposes of the Code.

Section 897 provides special rules for the disposition of an investment in U.S. real property. Section 897(a)(1) provides, in part, that gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a USRPI is taken into account under section 871(b)(1) or 882(a)(1) as if the nonresident alien individual or foreign corporation, respectively, were engaged in a trade or business in the United States during the taxable year and as if such gain or loss were effectively connected with such trade or business. Section 897(c)(1)(A) defines a USRPI to mean (i) an interest in real property located in the United States or the Virgin Islands and (ii) any interest (other than solely as a creditor) in a domestic corporation that is a United States real property holding corporation (USRPHC). As defined in section 897(c)(2), a USRPHC

means any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the total fair market value of its USRPIs, its interests in real property located outside the United States, and any other assets which are used or held for use in a trade or business.

Section 897(h)(1) provides that any distribution by a qualified investment entity to a nonresident alien individual, foreign corporation, or other qualified investment entity shall, to the extent attributable to gain from the sale or exchange by the qualified investment entity of a USRPI, be treated as gain recognized by such nonresident alien individual, foreign corporation, or other qualified investment entity from the sale or exchange of a USRPI. Thus, such distributions are taxable to such nonresident alien individual or foreign corporation under section 897(a)(1). For purposes of section 897(h)(1), a qualified investment entity means any REIT and any regulated investment company (RIC) described in section 897(h)(4)(A)(i)(II).

A foreign government is treated under Treas. Reg. § 1.897–9T(e) as a foreign person with respect to USRPIs. Further, Treas. Reg. §§ 1.897–9T(e) and 1.1445–10T(b) provide that a foreign government is subject to taxation under sections 897 and 1445 on the disposition of a USRPI "except to the extent specifically otherwise provided in the regulations issued under section 892."

The regulations issued under section 892 do not specifically exempt foreign governments from taxation under sections 897 and 1445. The flush language following Treas. Reg. § 1.892–3T(a)(1)(iii) provides that:

> Income derived from sources other than described in this paragraph [§ 1.892–3T(a)(1)] (such as income earned from a U.S. real property interest described in section 897(c)(1)(A)(i)) is not exempt from taxation under section 892. Furthermore, any gain derived from the disposition of a U.S. real property interest defined in section 897(c)(1)(A)(i) shall in no event qualify for exemption under section 892.

This language makes it clear that gain from the disposition of a USRPI described in section 897(c)(1)(A)(i) is not exempt from taxation under section 892. Gain derived by a foreign government from the disposition of a USRPI defined in section 897(c)(1)(A)(ii) (*i.e.*, an interest in a USRPHC), however, is exempt from tax under Treas. Reg. § 1.892–3T if the USRPHC does not constitute a controlled commercial entity under section 892(a)(2)(B). *See Example (1)* of Treas. Reg. § 1.892–3T(b).

TREATMENT OF DISTRIBUTIONS UNDER SECTION 897(h)(1)

1. Distributions During the Life of the REIT

Section 897(h)(1) treats any distribution by a qualified investment entity to a foreign corporation as gain recognized by the foreign corporation from the disposition of a USRPI to the extent that the distribution is attributable to gains from sales or exchanges by the qualified investment entity of USRPIs. As a result, to the extent that such distributions are attributable to gain recognized from sales or exchanges of a USRPI, the distributions are subject to U.S. income taxation under sections 897(a)(1) and 882(a)(1) as effectively connected income and to withholding under section 1445(e). In addition, where applicable, such distributions are treated and taxed as gain attributable to the alienation of a USRPI under the capital gains articles of U.S. income tax treaties.

Accordingly, the IRS will challenge under current statutory and regulatory provisions an assertion that section 892 exempts from taxation (and withholding) distributions from a qualified investment entity that are treated under section 897(h)(1) as gain recognized by a foreign government shareholder from the sale or exchange of a USRPI described in section 897(c)(1)(A)(i). In addition, Treasury and the IRS will clarify in regulations that the language in Treas. Reg. § 1.892–3T(a)(1) denying exemption from taxation with respect to a disposition of a USRPI defined in section 897(c)(1)(A)(i) applies also to distributions attributable to gain from the sale or exchange of USRPIs to which section 897(h)(1) applies. Thus, the regulations will clarify that distributions received by a foreign government from a qualified investment entity that are attributable to gain from sales or exchanges by the qualified investment entity of USRPIs described in section 897(c)(1)(A)(i) are not exempt from taxation under section 892. Instead, the regulations will clarify that such distributions are subject to U.S. income taxation under section 882(a)(1) as effectively connected income pursuant to section 897(a)(1) and to withholding under section 1445(e). In addition, the regulations will clarify that, where applicable, such distributions are treated and taxed as gain attributable to the alienation of a USRPI under the capital gains articles of U.S. income tax treaties.

2. Liquidating Distributions

Sections 897(h)(1) and 1445(e)(6) by their terms apply to all distributions to the extent attributable to gain from sales or exchanges by the qualified investment entity of a USRPI. Accordingly, the IRS will challenge under current statutory and regulatory provisions an assertion by any foreign taxpayer that section 897(h)(1) does not apply to distributions in complete liquidation under sections 331 and 332. In addition, regulations will clarify that the application of section 897(h)(1) and withholding under section 1445(e) is not limited to distributions by qualified investment entities that are subject to section 316. The regulations will clarify that the term "distribution," as used in sections 897(h)(1) and 1445(e)(6), includes any distribution included under sections 301, 302, 331, and 332, where the distribution is attributable, in whole or in part, to gain from the sale or exchange of a USRPI by a qualified investment entity or other pass-through entity.

EFFECTIVE DATE

Regulations incorporating the guidance in this notice will apply to distributions occurring on or after June 13, 2007.

DRAFTING INFORMATION

The principal authors of this notice are David A. Juster and Margaret A. Hogan of the Office of the Associate Chief Counsel (International). However, other personnel from Treasury and the IRS participated in its development. For further information regarding section 892 issues in this notice, contact Mr. Juster at (202) 622–3850 (not a toll-free call). For further information regarding section 897 issues in this notice,

contact Ms. Hogan at (202) 622–3860 (not a toll-free call).

Change of Address for Submission of CREBs Applications

Notice 2007–56

This notice changes the address for submission by mail of applications for allocations of the national clean renewable energy bond ("CREB") volume limitation ("volume cap") allocations under section 54 of the Internal Revenue Code (the "Code") and Notice 2007–26, 2007–14 I.R.B. 870 (April 2, 2007). Applicants for CREB volume cap allocations submitting applications *by mail* must send their applications to Internal Revenue Service (IRS), Attention: Deb Beaulieu, 56 Inverness Drive East MS 7222, Englewood, CO 80112. This notice *modifies* Notice 2007–26, which provides guidance on CREBs in connection with the allocation process for the available volume cap authorization under section 54.

Section 1303 of the Energy Tax Incentives Act of 2005, Pub. L. No. 109–58, 119 Stat. 594 (2005) (the "2005 Act"), added section 54 to the Code. Section 54 originally provided for a total national volume cap of $800 million for CREBs to finance eligible clean renewable energy projects. Pursuant to the 2005 Act, during 2006 the Internal Revenue Service allocated the $800 million volume cap to qualified clean renewable energy projects.

Section 202 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, 120 Stat. 2922 (2006) (the "2006 Act"), amended section 54, in part, by increasing the total national volume cap for CREBs from $800 million to $1.2 billion. Pursuant to the 2006 Act, Notice 2007–26 solicits applications of the available CREB volume cap as described in section 6 of Notice 2007–26.

Section 3.d. of Notice 2007–26 provides that CREB applications must be submitted in one of the following ways: (1) by hard copy in duplicate accompanied by a copy of the application in electronic format on compact disc ("CD") by mail to the Internal Revenue Service (IRS), Attention SE:T:GE:TEB, 1111 Constitution Avenue, NW, PE – 5N3, Washington, D.C. 20224; (2) by hard copy in duplicate accompanied by a copy of the application in electronic format on compact disc ("CD") by hand delivery Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, PE – 5N3, Washington, D.C., attention SE:T:GE:TEB; or (3) by electronic submission in PDF format of a copy of a signed original document to the IRS to *Tina.F.Hill@irs.gov*.

This notice changes the address to which applicants may send applications for CREB volume cap authority *by mail* only. Item (1) of section 3.d. of Notice 2007–26 is amended to read as follows: "(1) by hard copy in duplicate accompanied by a copy of the application in electronic format on compact disc ("CD") by mail to the Internal Revenue Service (IRS), Attention: Deb Beaulieu, 56 Inverness Drive East MS 7222, Englewood, CO 80112;".

This notice *modifies* Notice 2007–26. This notice is effective immediately upon release.

The principal authors of this notice are Zoran Stojanovic and Timothy L. Jones of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Tina Hill at (202) 283–9774 (not a toll-free call).

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941).

Rev. Proc. 2007–42

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Section 1 – Purpose

.01 The purpose of this publication is to provide general rules and specifications from the Internal Revenue Service (IRS) for paper and computer-generated substitutes for the January 2007 revision of Form 941, Employer's QUARTERLY Federal Tax Return, and for the January 2006 revision of Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors.

Note. Substitute territorial forms (941-PR, 941-SS, and Anexo B (Forma 941-PR)) should also conform to the specifications outlined in this revenue procedure.

.02 This publication provides measurements and printing specifications for substitute Form 941 and Schedule B (Form 941). If you need more in-depth information on who must complete the forms and how to complete them, see the Instructions for Form 941 and Publication 15 (Circular E), Employer's Tax Guide, or visit the IRS website at *www.irs.gov.*

.03 Forms should not be submitted to the IRS for specific approval. If you are uncertain of any specification and want clarification, do the following.

(1) Submit a letter citing the specification.

(2) State your understanding of the specification.

(3) Enclose an example (if appropriate) of how the form would appear if produced using your understanding.

(4) Use the following address. Be sure to include your name, complete address, phone number, and, if applicable, your email address with your correspondence.

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, IR-6406
1111 Constitution Avenue, NW
Washington, DC 20224

Note. Allow at least 30 days for the IRS to respond.

.04 However, software developers and form producers should send a blank copy of their substitute Form 941 and Schedule B (Form 941) in pdf format to *Dorene.Beard@irs.gov*. The purpose is not specifically for approval but to assist the IRS in preparing to scan these forms. Submitters will only receive comments if a significant problem is discovered through this process. Submitters are not expected to delay marketing their forms in order to receive feedback. In no case should submitters include "live" taxpayer data.

.05 The six-digit form ID (95xxxx) on Form 941 and Schedule B (Form 941) identifies the official substitute paper form. The six-digit form ID (97xxxx) identifies substitute 6x10 grid Form 941 and Schedule B (Form 941). The six-digit form ID (99xxxx) identifies the official IRS issued Form 941 and Schedule B (Form 941). The last two digits of the code identify the calender year. For example, the last two digits of ID code 97107 identifies calender year 2007.

Section 2 – What's New

.01 There are new 6x10 grid layouts for the 2007 revisions of Form 941.

.02 There are no changes to the January 2006 revision of Schedule B (Form 941), and therefore, this revision remains useable.

.03 We added the year to the heading for the "Report for this Quarter" box in the upper right corner of page 1.

.04 We added space between line 13 and the instructions below it.

.05 We deleted the entry space for the third party designee's telephone number in Part 4 on page 2. In addition, we moved the text "Personal Identification Number" and the fill-in boxes for the number to the left to line up under "Designee's name."

.06 To increase visibility, we reformatted the signature section in Part 5 on page 2 to conform to the signature areas of new Form 944.

.07 We made changes to the text of the instructions to the payment voucher, Form 941-V. We revised the first sentence of the third paragraph in the section "Making Payments With Form 941."

.08 We changed the wording of the second line of text for line 12 from "Make checks payable to United States Treasury" to "Follow the Instructions for Form 941-V, Payment Voucher."

Section 3 – General Requirements for Reproducing IRS Official Form 941 and Schedule B (Form 941)

.01 Do not submit substitute Form 941 and Schedule B (Form 941) to the IRS for approval. Substitute Form 941 and Schedule B (Form 941) that **completely conform** to the specifications contained in this revenue procedure do not require prior approval from the IRS.

.02 Print the form on paper that is 8.5 inches wide by 11 inches deep.

.03 Use white paper that meets generally-accepted weight, color, and quality standards (minimum 20 lb. white bond paper).

Note. Reclaimed fiber in any percentage is permitted provided that the requirements of this standard are met.

.04 The IRS prefers printing Form 941 on both sides of a single sheet of paper, but it is acceptable to print on one side of each of two separate sheets of paper.

.05 Make substitute paper forms as identical to the official IRS-printed forms as possible.

.06 Print using nonreflective black inks.

.07 Use typefaces that are substantially identical in size and shape to the official forms and use rules and shading that are substantially identical to those on the official forms.

.08 Print the six-digit form ID codes in the upper right-hand corner of each form using nonreflective black, carbon-based, 12-point (minimum 10-point required) OCR-A font. Use the official paper over-the-counter IRS forms to develop your substitute paper forms. Print "950107" on page 1 of Form 941, "950207" on page 2 of Form 941, and "950306" on Schedule B (Form 941) of substitute paper forms. See Section 4 for form ID codes for software-generated forms.

Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

.09 Print the OMB number in the same location as on the official forms.

.10 Print all entry boxes and checkboxes exactly as shown on the official forms.

.11 Print your IRS-issued three-letter substitute form printer source code in the middle at the bottom of page 1 of Form 941.

Note. You can obtain a three-letter substitute form printer source code by requesting it by email at **taxforms@irs.gov*. (The asterisk must be included in the address.) Please enter "Substitute Forms" on the subject line.

.12 Print "For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher" at the bottom of page 1 of Form 941.

.13 Print "For Paperwork Reduction Act Notice, see separate instructions" at the bottom of Schedule B (Form 941).

.14 Do not print the form catalog number ("Cat. No.") at the bottom of the forms or instructions.

.15 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

.16 See Exhibits A and B in Section 8.

Section 4 – Reproducing Form 941 and Schedule B (Form 941) for Software-Generated Paper Forms

.01 You may use the 6x10 grid exhibits (C and D) at the end of this document to develop a software version of Form 941 and Schedule B (Form 941). Please follow the specifications exactly to develop the fields.

.02 If you are developing software that is designed using the 6x10 grid in the exhibits, you may make the following modifications. See Exhibits C and D in Section 8.

- Use "970107" for page 1 of Form 941, "970207" for page 2 of Form 941, and "970306" for Schedule B (Form 941) as the form ID codes.

  Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

- Place all boxes and entry spaces in the same field locations as indicated in the 6x10 grid exhibits.

- Use single lines for "Employer Identification Number" (EIN) and other entry areas in the entity section of page 1 of Form 941.

- You do not need to use reverse type as shown on the IRS official form.

- You do not need to pre-print decimal points in the data boxes. However, where the amounts are required, the amounts should be printed with decimal points and place holders for cents.

- Use a single box for "state abbreviation" in line 14 of Form 941.
- Delete the pre-printed formatting in the "date" box for line 16 and in Parts 5 and 6 of Form 941.
- Delete the pre-printed formatting in the "Phone" box for Parts 5 and 6.
- Use a single box for "Personal Identification Number (PIN)" in Part 4 of Form 941.
- You may delete all shading when using the 6x10 grid format.

.03 If producing both the form and the data or the form only, print your three-letter IRS-issued form printer source code in Row 63, Columns 49-51 on page 1 of Form 941. See Section 3.11.

.04 If producing only the data on the form, print your four-digit software industry form code in Row 4, Columns 58-61 on page 1 of Form 941. See the National Association of Computerized Tax Processors (NACTP) website at *www.nactp.org* for information on these codes.

.05 Print "For Privacy Act and Paperwork Reduction Act Notice, see the Payment Voucher" at the bottom of page 1 of Form 941.

.06 Print "For Paperwork Reduction Act Notice, see separate instructions" at the bottom of Schedule B (Form 941).

.07 Do not print the form catalog number ("Cat. No.") at the bottom of the forms or instructions.

.08 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

.09 To enable accurate scanning and processing, enter data on Form 941 and Schedule B (Form 941) as follows:

- Show name and EIN on all pages and attachments.
- Use 12-point (minimum 10-point) Courier font (if possible).
- Omit dollar signs, but use commas to show amounts.
- Except for lines 1, 2, and 10, leave blank any data field with a value of zero.
- Enter negative amounts with a minus sign. For example, report "-10.59" instead of "(10.59)."

  Note. The IRS prefers that you use a minus sign for negative amounts instead of parentheses or some other means. However, if your software only allows for parentheses in reporting negative amounts, you may use them.

Section 5 – OMB Requirements for Substitute Forms

.01 The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires the following.

- The Office of Management and Budget (OMB) approves all IRS tax forms that are subject to the Act.
- Each IRS form contains the OMB approval number, if assigned. (The official OMB numbers may be found on the official IRS forms and are also shown on the forms in the exhibits.)
- Each IRS form (or its instructions) states:

  (1) Why the IRS needs the information,

  (2) How it will be used, and

  (3) Whether or not the information is required to be furnished to the IRS.

.02 This information must be provided to any users of official or substitute IRS forms or instructions.

.03 The OMB requirements for substitute IRS forms are the following.

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Form 941 and Schedule B (Form 941), the OMB number (1545-0029) must appear exactly as shown on the official IRS form.
- For Form 941 and Schedule B (Form 941), the OMB number must use one of the following formats.

  (1) OMB No. 1545-0029 (preferred) or

  (2) OMB # 1545-0029 (acceptable).

.04 If no instructions are provided to users on your forms, you must furnish to them the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 6 – Reproducible Copies of Forms

.01 You can order official IRS forms and information copies of federal tax materials at local IRS offices or by calling the IRS National Distribution Center at 1-800-829-3676. Other ways to get federal tax material include the following.

- The IRS website at *www.irs.gov*.

- The IRS' CD (Publication 1796).

.02 The IRS also offers an alternative to downloading electronic files and provides current and prior year access to tax forms and instructions through its Federal Tax Forms CD. Order Publication 1796, IRS Federal Tax Products CD, by using the IRS website at *www.irs.gov/cdorders* or by calling 1-877-CDFORMS (1-877-233-6767).

Section 7 – Effect on Other Documents

.01 Revenue Procedure 2006-25, 2006-21 I.R.B. 926 (reproduced as Publication 4436, Rev. 5-2006) is superseded.

Section 8 – Exhibits

.01 Please follow the specifications indicated in the following exhibits to produce substitute Form 941 and Schedule B (Form 941).

.02 These forms are subject to review and possible change as required. Therefore, employers are cautioned against overstocking supplies of privately-printed substitutes.

.03 Do not submit substitute Form 941 and Schedule B (Form 941) to the IRS for approval. Substitute Form 941 and Schedule B (Form 941) that **completely conform** to the specifications contained in this revenue procedure may be privately printed without prior approval from the IRS.

Exhibit A, Form 941 (Official Version)

.5" .9" .85"

Form **941 for 2007: Employer's QUARTERLY Federal Tax Return** 950107
(Rev. January 2007) Department of the Treasury — Internal Revenue Service .25" OMB No. 1545-0029

(EIN)
Employer identification number 3.2"

Name *(not your trade name)* 3.45"

1.75"

Trade name *(if any)* 3.75"

Address 4.25"

Number Street Suite or room number

2.55" .5" 1.0"

City State ZIP code

5.0"

Report for this Quarter of 2007
(Check one.)

.17"

☐ **1:** January, February, March

2.5"

☐ **2:** April, May, June

1.85"

☐ **3:** July, August, September

☐ **4:** October, November, December

2.15"

Read the separate instructions before you fill out this form. Please type or print within the boxes.

Part 1: Answer these questions for this quarter.

1 **Number of employees who received wages, tips, or other compensation for the pay period including:** ***Mar. 12*** **(Quarter 1),** ***June 12*** **(Quarter 2),** ***Sept. 12*** **(Quarter 3),** ***Dec. 12*** **(Quarter 4)** . . . 1

2 **Wages, tips, and other compensation** 2

3 **Total income tax withheld from wages, tips, and other compensation** 3

4 **If no wages, tips, and other compensation are subject to social security or Medicare tax** . ☐ Check and go to line 6.

5 **Taxable social security and Medicare wages and tips:**

	Column 1		*Column 2*
5a Taxable social security wages	.	× .124 =	.
5b Taxable social security tips	.	× .124 =	.
5c Taxable Medicare wages & tips	.	× .029 =	.

1.45"

7.90"

5d **Total social security and Medicare taxes** (*Column 2*, lines 5a + 5b + 5c = line 5d) . . 5d

6 **Total taxes before adjustments** (lines 3 + 5d = line 6) . . . . 6 1.8"

7 **TAX ADJUSTMENTS** (Read the instructions for line 7 before completing lines 7a through 7h.):

7a **Current quarter's fractions of cents** . . . .

7b **Current quarter's sick pay** . . . . 1.45"

4.2"

7c **Current quarter's adjustments for tips and group-term life insurance**

7d **Current year's income tax withholding** (attach Form 941c) . . .

7e **Prior quarters' social security and Medicare taxes** (attach Form 941c)

7f **Special additions to federal income tax** (attach Form 941c) . . .

7g **Special additions to social security and Medicare** (attach Form 941c)

2.2"

.5" .5"

7h **TOTAL ADJUSTMENTS** (Combine all amounts: lines 7a through 7g.) 7h

8 **Total taxes after adjustments** (Combine lines 6 and 7h.) . . . . 8 .25"

9 **Advance earned income credit (EIC) payments made to employees** 9

10 **Total taxes after adjustment for advance EIC** (line 8 – line 9 = line 10) 10

11 **Total deposits for this quarter, including overpayment applied from a prior quarter** . . 11

12 **Balance due** (If line 10 is more than line 11, write the difference here.) 12
Follow the Instructions for Form 941-V, Payment Voucher.

13 **Overpayment** (If line 11 is more than line 10, write the difference here.) . Check one ☐ Apply to next return. ☐ Send a refund.

.4"

▶ You **MUST** fill out both pages of this form and **SIGN** it. **Next** ➡

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. .5" Form **941** (Rev. 1-2007)

Exhibit A, Form 941 (Official Version) (continued)

.7"

.5"

950207

Name (not your trade name) | Employer identification number (EIN)

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see *Pub. 15 (Circular E)*, section 11.

.9"

14 Write the state abbreviation for the state where you made your deposits OR write "MU" if you made your deposits in *multiple* states.

15 Check one: ☐ **Line 10 is less than $2,500.** Go to Part 3.

☐ **You were a monthly schedule depositor for the entire quarter. Fill out your tax liability for each month.** Then go to Part 3.

Tax liability: Month 1 .25"

Month 2 1.8"

Month 3

Total liability for quarter — Total must equal line 10.

.5" 9.5" .5"

☐ **You were a semiweekly schedule depositor for any part of this quarter.** Fill out *Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors,* and attach it to this form.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

16 **If your business has closed or you stopped paying wages** . . . . ☐ Check here, and

enterthefinaldateyoupaidwages 1.1"

17 **If you are a seasonal employer and you do not have to file a return for every quarter of the year** . . ☐ Check here.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? (See the instructions for details.)

☐ Yes. Designee's name 5.5"

Select a 5-digit Personal Identification Number (PIN) to use when talking to IRS. 1.4"

☐ No.

Part 5: Sign here. You MUST fill out both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

X Sign your name here 3.0"

Print your name here 2.0"

Print your title here

Date / 1.1" /

Best daytime phone ( ) 1.6" –

Part 6: For paid preparers only *(optional)*

Paid Preparer's Signature

Firm's name

Address 3.6"

EIN 1.75"

ZIP code

Date / / Phone ( ) – SSN/PTIN

☐ Check if you are self-employed.

Page **2** — Form **941** (Rev. 1-2007)

.5"

Exhibit B, Schedule B (Form 941) (Official Version)

1.0"   3.5"   950306

Schedule B (Form 941):

Report of Tax Liability for Semiweekly Schedule Depositors

(Rev. January 2006)   Department of the Treasury — Internal Revenue Service   OMB No 1545-0029

(EIN) Employer identification number ◄ ☐☐ – ☐☐ 3.2" ☐☐☐☐☐ ►

Name *(not your trade name)* ◄ 3.45" ►

Calendar year ◄ ☐ 1.3" ☐ ►   (Also check quarter)

Report for this Quarter ...
(Check one.)

- ☐ **1:** January, February, March
- ☐ **2:** April, May, June
- ☐ **3:** July, August, September
- ☐ **4:** October, November, December

◄ 2.15" ►

Use this schedule to show your TAX LIABILITY for the quarter; DO NOT use it to show your deposits. You must fill out this form and attach it to Form 941 (or Form 941-SS) if you are a semiweekly schedule depositor or became one because your accumulated tax liability on any day was $100,000 or more. Write your daily tax liability on the numbered space that corresponds to the date wages were paid. See Section 11 in *Pub. 15 (Circular E), Employer's Tax Guide,* for details.

Month 1

1	.	9	◄ 1.3" ► .	17	.	25	.
2	.	10	.	18	.	26	.
3	.25" .	11	.	19	.	27	.
4	.	12	.	20	.	28	.
5	.	13	.	21	.	29	.
6	.	14	.	22	.	30	.
7	.	15	.	23	.	31	.
8	.	16	.	24	.		

Tax liability for Month 1
◄ 1.7" ► .

1.55"

Month 2

1	.	9	.	17	.	25	.
2	.	10	.	18	.	26	.
◄ .5" ► 3	.	11	.	19	.	27	.
4	.	12	.	20	6.2" .	28	.
5	.	13	.	21	.	29	.
6	.	14	.	22	.	30	.
7	.	15	.	23	.	31	.
8	.	16	.	24	.		

Tax liability for Month 2
.6"   .

◄ .5" ►

1.55"

Month 3

1	.	9	.	17	.	25	.
2	.	10	.	18	.	26	.
3	.	11	.	19	.	27	.
4	.	12	.	20	.	28	.
5	.	13	.	21	.	29	.
6	.	14	.	22	.	30	.
7	.	15	.	23	.	31	.
8	.	16	.	24	.		

Tax liability for Month 3
.

1.4"

Fill in your total liability for the quarter (Month 1 + Month 2 + Month 3) = Total tax liability for the quarter ►
Total must equal line 10 on Form 941 (or line 8 on Form 941-SS).

Total liability for the quarter
.5"   .

1.15"

For Paperwork Reduction Act Notice, see separate instructions.   **Schedule B (Form 941)** Rev. 1-2006

.6"

Exhibit C, Form 941 (6 x 10 Grid Version)

Form **941 for 2007: Employer's QUARTERLY Federal Tax Return** 970107
(Rev. January 2007) Department of the Treasury -- Internal Revenue Service OMB No. 1545-0029

(EIN)
Employer identification number ____________________

Name (not your trade name) ____________________
Trade name (if any) ____________________

Address ____________________
____

Report for this Quarter of 2007 (Check one.)
☐ 1: January, February, March
☐ 2: April, May, June
☐ 3: July, August, September
☐ 4: October, November, December

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), Dec. 12 (Quarter 4) . . . . . 1 ______

2 Wages, tips, and other compensation . . . . . 2 ______

3 Total income tax withheld from wages, tips, and other compensation . . . . . 3 ______

4 If no wages, tips, and other compensation are subject to social security or Medicare tax . . . . . ☐ Check and go to line 6.

5 Taxable social security and Medicare wages and tips:

		Column 1		Column 2
5a	Taxable social security wages		x .124 =	
5b	Taxable social security tips		x .124 =	
5c	Taxable Medicare wages & tips		x .029 =	

5d Total social security and Medicare taxes (Column 2, lines 5a + 5b + 5c = line 5d) . . . . . 5d ______

6 Total taxes before adjustments (lines 3 + 5d = line 6) . . . . . 6 ______

7 TAX ADJUSTMENTS (Read instructions for line 7 before completing lines 7a through 7h.):

7a Current quarter's fractions of cents . . . . . ______

7b Current quarter's sick pay . . . . . ______

7c Current quarter's adjustments for tips and group-term life insurance ______

7d Current year's income tax withholding (attach Form 941c) . . . . . ______

7e Prior quarters' social security and Medicare taxes (attach Form 941c) ______

7f Special additions to federal income tax (attach Form 941c) . . . . . ______

7g Special additions to social security and Medicare (attach Form 941c) ______

7h TOTAL ADJUSTMENTS (Combine all amounts: lines 7a through 7g.) . . . . . 7h ______

8 Total taxes after adjustments (Combine lines 6 and 7h.) . . . . . 8 ______

9 Advance earned income credit (EIC) payments made to employees . . . . . 9 ______

10 Total taxes after adjustment for advance EIC (line 8 – line 9 = line 10) . . . . . 10 ______

11 Total deposits for this quarter, including overpayment applied from a prior quarter . . . . . 11 ______

12 Balance due (If line 10 is more than line 11, enter the difference here.) . . . . . 12 ______
Follow the Instructions for Form 941-V, Payment Voucher.

13 Overpayment (If line 11 is more than line 10, enter the difference here.) . . . . . ______ Check one ☐ Apply to next return. ☐ Send a refund.

For Privacy Act and Paperwork Reduction Act Notice, see the Payment Voucher. Form 941 (Rev. 1-2007)

Exhibit C, Form 941 (6 x 10 Grid Version) (continued)

970207

Form **941** (Rev. 1-2007) Page **2**

Name (not your trade name)	**Employer identification number (EIN)**

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see Pub. 15 (Circular E), section 11.

14 ☐ **Enter the state abbreviation for the state where you made your deposits** OR **enter "MU" if you made your deposits in multiple states.**

15 Check one: ☐ **Line 10 is less than $2,500.** Go to Part 3.

☐ **You were a monthly schedule depositor for the entire quarter. Fill out your tax liability for each month.** Then go to Part 3.

Tax liability: **Month 1** ________

Month 2 ________

Month 3 ________

Total liability for quarter ________ **Total must equal line 10.**

☐ **You were a semiweekly schedule depositor for any part of this quarter.** Fill out Schedule B (Form 941): Report of Tax Liability for Semiweekly Schedule Depositors, and attach it to this form.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

16 **If your business has closed or you stopped paying wages** .... ☐ Check here, and

enter the final date you paid wages ________.

17 **If you are a seasonal employer and you do not have to file a return for every quarter of the year** .... ☐ Check here.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? (See instructions for details.)

☐ Yes. Designee's name ________

Select a 5-digit Personal Identification Number (PIN) to use when talking to IRS. ________

☐ No.

Part 5: Sign here. You MUST fill out both pages of this form and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Sign your name here ________ Print your name here ________

Print your title here ________

Date ________ Best daytime phone ________

Part 6: For paid preparers only (optional)

Paid Preparer's Signature ________

Firm's name ________

Address ________ EIN ________

________ ZIP code ________

Date ________ Phone ________ SSN/PTIN ________

☐ Check if you are self-employed.

Exhibit D, Schedule B (Form 941) (6 x 10 Grid Version)

Schedule B (Form 941): **Report of Tax Liability for Semiweekly Schedule Depositors**

Department of the Treasury -- Internal Revenue Service

OMB No. 1545-0029 970306

Calendar Year

Employer identification number

Name (not your trade name)

Report for this Quarter

- **1:** January, February, March
- **2:** April, May, June
- **3:** July, August, September
- **4:** October, November, December

Use this schedule to show your TAX LIABILITY for the quarter; DO NOT use it to show your deposits. You must fill out this form & attach it to Form 941 (or Form 941-SS) if you are a semiweekly schedule depositor or became one because your accumulated tax liability on any day was $100,000 or more. Enter your daily tax liability on the numbered space that corresponds to the date wages were paid.

Month 1

1	9	17	25	Tax liability for Month 1
2	10	18	26	
3	11	19	27	
4	12	20	28	
5	13	21	29	
6	14	22	30	
7	15	23	31	
8	16	24		

Month 2

1	9	17	25	Tax liability for Month 2
2	10	18	26	
3	11	19	27	
4	12	20	28	
5	13	21	29	
6	14	22	30	
7	15	23	31	
8	16	24		

Month 3

1	9	17	25	Tax liability for Month 3
2	10	18	26	
3	11	19	27	
4	12	20	28	
5	13	21	29	
6	14	22	30	
7	15	23	31	
8	16	24		Total liability for the quarter

Fill in your total liability for the quarter (Month 1 + Month 2 + Month 3) = Total tax liability for the quarter ▶

Total must equal line 10 on Form 941 (or line 8 on Form 941-SS).

For Paperwork Reduction Act Notice, see separate instructions. **Schedule B (Form 941)** Rev. 1-2006

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3.

26 CFR 601.602: Tax forms and instructions.
(Also Part I, Sections 6041, 6051, 6071, 6081, 6091; 1.6041–1, 1.6041–2, 31.6051–1, 31.6051–2, 31.6071(a)–1, 31.6081(a)–1, 31.6091–1.)

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Part A. General

Section 1. Purpose

.01 The purpose of this revenue procedure is to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) regarding the preparation and use of substitute forms for Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements, for wages paid during the 2007 calendar year.

.02 For purposes of this revenue procedure, substitute Form W-2 (Copy A) and substitute Form W-3 are forms that are not printed by the IRS. Copy A or any other copies of a substitute Form W-2 or a substitute Form W-3 must conform to the specifications in this revenue procedure to be acceptable to the IRS and the SSA. No IRS office is authorized to allow deviations from this revenue procedure. Preparers should also refer to the separate 2007 Instructions for Forms W-2 and W-3 for details on how to complete these forms. See Part C, Section 4, for information on obtaining the official IRS forms and instructions. See Part B, Section 2, for requirements for the copies of substitute forms furnished to employees.

.03 For purposes of this revenue procedure, the official, IRS-printed red dropout ink Forms W-2 (Copy A) and W-3 and their exact substitutes are referred to as "red-ink." The SSA-approved, laser-printed, black-and-white Forms W-2 (Copy A) and W-3 are referred to as "laser-printed."

Any questions about the red-ink Form W-2 (Copy A) and Form W-3 and the substitute employee statements should be emailed to *taxforms@irs.gov* (the asterisk must be included in the address). Please enter "Substitute Forms" on the subject line. Or send your questions to:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, IR 6406
1111 Constitution Ave., NW
Washington DC 20224

Any questions about the black-and-white laser-printed Form W-2 (Copy A) and Form W-3 should be emailed to *laser.forms@ssa.gov* or sent to:

Social Security Administration
Data Operations Center
Attn: Laser Forms Approval, Room 235
1150 E. Mountain Drive
Wilkes-Barre PA 18702-7997

Also, see Sections 3.05 and 3.06 of Part A.

Note. You should receive a response within 30 days from either the IRS or the SSA.

.04 The IRS maintains a centralized call site at its Enterprise Computing Center — Martinsburg (ECC) to answer questions related to information returns (Forms W-2, W-3, 1099 series, 1096, etc.). You can reach the call site at 304-263-8700 (not a toll-free number) or 1-866-455-7438 (toll-free). The Telecommunication Device for the Deaf (TDD) number is 304-267-3367 (not a toll-free number). The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m. Eastern time. IRS/ECC does not process Forms W-2 (Copy A). Forms W-2 (Copy A) prepared on paper and/or electronically must be filed with the SSA. IRS/ECC does, however, process waiver requests (Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically) and extension of time to file requests (Form 8809, Application for Extension of Time To File Information Returns) for Forms W-2 (Copy A) and requests for an extension of time to furnish the employee copies of Form W-2. See Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically, for information on waivers and extensions of time.

.05 The following form instructions and publications provide more detailed filing procedures for certain information returns:

- 2007 Instructions for Forms W-2 and W-3,
- Instructions for Forms W-2c and W-3c (Rev. January 2006), and
- Publication 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c.

Section 2. What's New

.01 Relocation of employee's SSN on Form W-2. We moved the "Employee's social security number" box on Form W-2 from box d to box a. We moved the "Control number" box, optionally used by some employers to identify individual Forms W-2, from box a to box d. We also relocated the form ID number ("22222") and "Void" boxes to the top left corner of Form W-2. We made these changes to protect the employee's SSN from disclosure when employers furnish Forms W-2 to their employees using a window envelope and to enhance processing efficiency.

.02 Relocation of form ID on Form W-3. For consistency with the revisions to Form W-2, we relocated the form ID number ("33333") to the top left corner of Form W-3.

.03 Form W-3PR. Form W-3PR is 7.3 inches wide and should be printed on 8.5 by 11-inch paper using a **.5-inch top margin with .6-inch left and right margins.**

.04 Logos and advertising. The IRS has identified questionable Forms W-2 as a key indicator of potentially abusive and fraudulent returns. Some questionable Forms W-2 may be confused with legitimate Forms W-2 that carry logos and advertisements. The IRS has received questions concerning whether a logo or an identifying slogan for an employer or other preparer is acceptable on the substitute employee statements. We were also asked whether an advertisement for tax preparation software or other marketing materials are acceptable on, or attached to, the substitute employee statements. The IRS is continuing to solicit comments regarding these questions. The IRS anticipates responding to these questions by revising the regulations concerning this issue after the comments have been considered, and it will include requirements brought about by the regulations in a future update of this revenue procedure. Send your comments to:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, IR 6406
1111 Constitution Ave., NW
Washington DC 20224

.05 Title change. SSA publication MMREF-1, Magnetic Media Reporting and Electronic Filing, has been changed to SSA publication EFW2, Specifications for Filing Forms W-2 Electronically.

.06 Editorial changes. We made editorial changes. Redundancies were eliminated as much as possible.

Section 3. General Rules for Paper Forms W-2 and W-3

.01 Employers not filing electronically must file paper Forms W-2 (Copy A) along with Form W-3 with the SSA by using either the official IRS form or a substitute form that exactly meets the specifications shown in Parts B and C of this revenue procedure.

Note. Substitute territorial forms (W-2AS, W-2GU, W-2VI) should also conform to the specifications as outlined in this revenue procedure. These forms require the form designation ("W-2AS," "W-2GU," "W-2VI") on Copy A to be in black ink. If you are an employer in the Commonwealth of the Northern Mariana Islands, you must contact the Division of Revenue and Taxation, Capitol Hill, Saipan, MP, 96950, to get Form W-2CM and instructions for completing and filing the form.

Employers who file with the SSA electronically or on paper may design their own statements to furnish to employees. These employee statements designed by employers must comply with the requirements shown in Parts B and C.

.02 Red-ink substitute forms that completely conform to the specifications contained in this revenue procedure may be privately printed without prior approval from the IRS or the SSA. Only the black-and-white laser-printed forms need to be submitted to the SSA for approval (see Section 1B of Part B).

.03 As in the past, Form W-2 (Copy A) and Form W-3 may be generated using a laser-printer by following all guidelines and specifications (also see Section 1B of Part B). In general, regardless of the method of entering data, using black ink on Forms W-2 and W-3 provides better readability for processing by scanning equipment. Colors other than black are not easily read by the scanner and may result in delays or errors in the processing of Forms W-2 (Copy A) and W-3. The printing of the data should be centered within the boxes. The size of the variable data must be printed in a font no smaller than 10-point.

Note. With the exception of the identifying number, the year, the form number for Form W-3, and the corner register marks, the preprinted form layout for the red-ink Forms W-2 (Copy A) and W-3, must be in Flint J-6983 red OCR dropout ink or an exact match. (See Section 1A.03 of Part B.)

.04 Substitute forms filed with the SSA and substitute copies furnished to employees that do not conform to these specifications are unacceptable. Forms W-2 (Copy A) and W-3 filed with the SSA that do not conform may be returned. In addition, penalties may be assessed for not complying with the form specifications.

.05 Substitute red-ink forms should not be submitted to either the IRS or the SSA for specific approval. If you are uncertain of any specification and want clarification, do the following.

(1) Submit a letter or email citing the specification to the appropriate address in section 3.06.

(2) State your understanding of the specification.

(3) Enclose an example (if appropriate) of how the form would appear if produced using your understanding.

(4) Be sure to include your name, complete address, phone number, and if applicable, your email address with your correspondence.

.06 Any questions about the specifications, especially those for the red-ink Form W-2 (Copy A) and Form W-3, should be emailed to **taxforms@irs.gov* (the asterisk must be included in the address). Please enter "Substitute Forms" on the subject line. Or send your questions to:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, IR 6406
1111 Constitution Ave., NW
Washington DC 20224

Any questions about the black-and-white laser-printed Form W-2 (Copy A) and Form W-3 should be emailed to *laser.forms@ssa.gov* or sent to:

Social Security Administration
Data Operations Center
Attn: Laser Forms Approval, Room 235
1150 E. Mountain Drive
Wilkes-Barre PA 18702–7997

Note. You should receive a response within 30 days from either the IRS or the SSA.

.07 Forms W-2 and W-3 are subject to annual review and possible change. Therefore, employers are cautioned against overstocking supplies of privately-printed substitutes.

.08 Separate instructions for Forms W-2 and W-3 are provided in the 2007 Instructions for Forms W-2 and W-3. Form W-3 should be used only to transmit paper Forms W-2 (Copy A). Form W-3 is a single sheet including only essential filing information. Be sure to make a copy of your completed Form W-3 for your records. Copies of the current year official IRS Forms W-2 and W-3, and the instructions for those forms, may be obtained from most IRS offices or by calling 1-800-829-3676. The IRS provides only cutsheet sets of Forms W-2 and cutsheets of Form W-3. The instructions and information copies of the forms may also be found on the IRS website at *www.irs.gov*.

.09 Because substitute Forms W-2 (Copy A) and W-3 are machine-imaged and scanned by the SSA, the forms must meet the same specifications as the official IRS Forms W-2 and W-3 (as shown in the exhibits).

Section 4. General Rules for Filing Forms W-2 (Copy A) Electronically

.01 Employers must file Forms W-2 (Copy A) with the SSA electronically if they file 250 or more calendar year 2007 Forms W-2 (Copy A) during a calendar year unless the IRS granted a waiver. For details, get the 2007 Instructions for Forms W-2 and W-3. The SSA publication EFW2, Specifications for Filing Forms W-2 Electronically, contains specifications and procedures for electronic filing of Form W-2 information with the SSA. Employers are cautioned to obtain the most recent revision of EFW2 (and supplements) due to any subsequent changes in specifications and procedures.

.02 You may obtain a copy of the EFW2 by:

- Accessing the SSA website at:
  www.socialsecurity.gov/employer/pub.htm,

- Writing to:

  Social Security Administration
  OCO, DES; Attn: Employer Reporting Services Center
  300 North Greene Street
  Baltimore MD 21290-0300

- Calling your local SSA Employer Services Liaison Officer (ESLO) (the ESLOs' phone numbers are available at: *www.socialsecurity.gov/employer/empcontacts.htm*), or

- Calling the SSA's Employer Reporting Services staff at 1-800-772-6270.

.03 Electronic filers do not file a paper Form W-3. See the SSA publication EFW2 for guidance on transmitting Form W-2 (Copy A) information to SSA electronically.

.04 Employers with fewer than 250 Forms W-2 are encouraged to electronically file Forms W-2 (Copy A) with the SSA. Doing so will enhance the timeliness and accuracy of forms processing.

.05 Employers who do not comply with the electronic filing requirements for Form W-2 (Copy A) and who are not granted a waiver by the IRS may be subject to penalties. Employers who file Form W-2 information with the SSA electronically must not send the same data to the SSA on paper Forms W-2 (Copy A). Any duplicate reporting may subject filers to unnecessary contacts by the SSA or the IRS.

Part B. Specifications for Substitute Forms W-2 and W-3

Section 1A. Specifications for Red-Ink Substitute Form W-2 (Copy A) and Form W-3 Filed with the SSA

.01 The official IRS-printed red dropout ink Form W-2 (Copy A) and W-3 and their exact substitutes are referred to as red-ink in this revenue procedure. Employers may file substitute Forms W-2 (Copy A) and W-3 with the SSA. The substitute forms must be exact replicas of the official IRS forms with respect to layout and content because they will be read by scanner equipment.

.02 Paper used for cutsheets and continuous-pinfed forms for substitute Form W-2 (Copy A) and Form W-3 that are to be filed with the SSA must be white 100% bleached chemical wood, 18-20 pound paper only, optical character recognition (OCR) bond produced in accordance with the following specifications:

• Acidity: Ph value, average, not less than	4.5
• Basis weight: 17 x 22 inch 500 cut sheets, pound	18-20
• Metric equivalent—gm./sq. meter	
(a tolerance of +5 pct. is allowed)	68-75
• Stiffness: Average, each direction, not less than—milligrams	
Cross direction	50
Machine direction	80
• Tearing strength: Average, each direction, not less than—grams	40
• Opacity: Average, not less than—percent	82
• Reflectivity: Average, not less than—percent	68
• Thickness: Average—inch	0.0038
Metric equivalent—mm	0.097
(a tolerance of +0.0005 inch (0.0127 mm) is allowed) Paper cannot vary more than 0.0004 inch (0.0102 mm) from one edge to the other.	
• Porosity: Average, not less than—seconds	10
• Finish (smoothness): Average, each side—seconds	20-55
(for information only) the Sheffield equivalent—units	170-d200
• Dirt: Average, each side, not to exceed—parts per million	8

Note. Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met.

.03 All printing of substitute Forms W-2 (Copy A) and W-3 must be in Flint red OCR dropout ink except as specified below. The following must be printed in nonreflective black ink:

- Identifying number "22222" or "33333" at the top of the forms.
- Tax year at the bottom of the forms.
- The four (4) corner register marks on the forms.
- The form identification number ("W-3") at the bottom of Form W-3.
- All the instructions below Form W-3 beginning with "Send this entire page...." line to the bottom of Form W-3.

.04 The vertical and horizontal spacing for all federal payment and data boxes on Forms W-2 and W-3 must meet specifications. On Form W-3 and Form W-2 (Copy A), all the perimeter rules must be 1-point (0.014-inch), while all other rules must be one-half point (0.007-inch). Vertical rules must be parallel to the left edge of the form; horizontal rules parallel to the top edge.

.05 The official red-ink Form W-3 and Form W-2 (Copy A) are 7.5 inches wide. Employers filing Forms W-2 (Copy A) with the SSA on paper must also file a Form W-3. Form W-3 must be the same width (7.5 inches) as the Form W-2. One Form W-3 is printed

on a standard-size, 8.5 x 11-inch page. Two official Forms W-2 (Copy A) are contained on a single 8.5 x 11-inch page (exclusive of any snap-stubs).

.06 The top, left, and right margins for the Form W-2 (Copy A) and Form W-3 are .5 inches (1/2 inch). All margins must be free of printing except for the words "DO NOT STAPLE" on red-ink Form W-3. The space between the two Forms W-2 (Copy A) is 1.33 inches.

.07 The identifying numbers are "22222" for Form W-2 (Copies A (and 1)) and "33333" for Form W-3. No printing should appear anywhere near the identifying numbers.

Note. The identifying number must be printed in nonreflective black ink in OCR-A font of 10 characters per inch.

.08 The depth of the individual scannable image on a page must be the same as that on the official IRS forms. The depth from the top line to the bottom line of an individual Form W-2 (Copy A) must be 4.17 inches and the depth from the top line to the bottom line of Form W-3 must be 4.67 inches. (See Exhibits A and B.)

.09 Continuous-pinfed Forms W-2 (Copy A) must be separated into 11-inch deep pages. The pinfed strips must be removed when Forms W-2 (Copy A) are filed with the SSA. The two Forms W-2 (Copy A) on the 11-inch page must not be separated (only the pages are to be separated (burst)). The words "Do Not Cut, Fold, or Staple Forms on This Page" must be printed twice between the two Forms W-2 (Copy A) in Flint red OCR dropout ink. Perforations are required on all other copies (Copies 1, B, C, 2, and D) to enable the separation of individual forms.

.10 Box 12 of Form W-2 (Copy A) contains four entry boxes – 12a, 12b, 12c, and 12d. Do not make more than one entry per box. Enter your first code in box 12a (for example, enter Code D in box 12a, not 12d, if it is your first entry). If more than four items need to be reported in box 12, use a second Form W-2 to report the additional items (see "Multiple forms" in the 2007 Instructions for Forms W-2 and W-3). Do not report the same federal tax data to the SSA on more than one Form W-2 (Copy A). However, repeat the identifying information (employee's name, address, and SSN; employer's name, address, and EIN) on each additional form.

.11 The checkboxes in box 13 of Form W-2 (Copy A) must be .14 inches each; the space before the first checkbox is .20 inches; the spacing on each remaining side of the 3 checkboxes is .36 inches (see Exhibit A). The checkboxes in box b of Form W-3 must also be .14 inches (see Exhibit B for other dimensions in box b).

Note. More than 50% of an applicable checkbox must be covered by an "X."

.12 All substitute Forms W-2 (Copy A) and W-3 in the red-ink format must have the tax year, form number, and form title printed on the bottom face of each form using type identical to that of the official IRS form. The red-ink substitute Form W-2 (Copy A) and Form W-3 must have the form producer's EIN entered directly to the left of "Department of the Treasury," in red.

.13 The words "For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D." must be printed in Flint red OCR dropout ink in the same location as on the official Form W-2 (Copy A). The words "For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D of Form W-2." must be printed at the bottom of the page of Form W-3 in black ink.

.14 The Office of Management and Budget (OMB) Number must be printed on substitute Forms W-3 and W-2 (on each ply) in the same location as on the official IRS forms.

.15 All substitute Forms W-3 must include the instructions that are printed on the same sheet below the official IRS form.

.16 The back of substitute Form W-2 (Copy A) and Form W-3 must be free of all printing.

.17 All copies must be clearly legible. Hot wax and cold carbon spots are not permitted for Form W-2 (Copy A). Interleaved carbon should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

.18 Chemical transfer paper is permitted for Form W-2 (Copy A) only if the following standards are met:

- Only chemically-backed paper is acceptable for Form W-2 (Copy A). Front and back chemically-treated paper cannot be processed properly by scanning equipment.
- Chemically-transferred images must be black.
- Carbon-coated forms are not permitted.

.19 The Government Printing Office (GPO) symbol and the Catalog Number (Cat. No.) must be deleted from substitute Form W-2 (Copy A) and Form W-3.

Section 1B. Specifications for Laser-Printed Substitute Form W-2 (Copy A) and Form W-3 Filed with the SSA

.01 The SSA-approved, laser-printed, black-and-white Forms W-2 (Copy A) and W-3 are referred to as laser-printed. Specifications for the laser-printed (black-and-white) Forms W-2 (Copy A) and W-3 are similar to the red-ink forms (Part B, Section 1A) except for the items that follow (see Exhibits E and F). Exhibits are samples only and must not be downloaded to meet tax obligations.

(1) Forms must be printed on 8.5 x 11-inch single-sheet paper only, not on continuous-feed using a laser printer. There must be two Forms W-2 (Copy A) printed on a page. There must be no horizontal perforations between the two Forms W-2 (Copy A) on each page.

(2) All forms and data must be printed in nonreflective black ink only.

(3) The data and forms must be programmed to print simultaneously. Forms cannot be produced separately from wage data entries.

(4) The forms must not contain corner register marks.

(5) The forms must not contain any shaded areas including those boxes that are entirely shaded on the red-ink forms.

(6) Identifying numbers on both Form W-2 ("22222") and Form W-3 ("33333") must be preprinted in 14-point Arial bold font or a close approximation.

(7) The form numbers ("W-2" and "W-3") must be in 18-point Arial font or a close approximation. The tax year ("2007") on Forms W-2 (Copy A) and W-3 must be in 20-point Arial font or a close approximation.

(8) No part of the box titles or the data printed on the forms may touch any of the vertical or horizontal lines, nor should any of the data intermingle with the box titles. The data should be centered in the boxes.

(9) Do not print any information in the margins of the laser-printed forms (for example, do not print "DO NOT STAPLE" in the top margin of Form W-3).

(10) The word "Code" must not appear in box 12 on Form W-2 (Copy A).

(11) A 4-digit vendor code preceded by four zeros and a slash (for example, 0000/1234) must appear in 12-point Arial font, or a close approximation, under the tax year in place of the Cat. No. on Form W-2 (Copy A) and in the bottom right corner of the "For Official Use Only" box at the bottom of Form W-3. Do not display the form producer's EIN to the left of "Department of the Treasury." The vendor code will be used to identify the form producer.

(12) Do not print Catalog Numbers (Cat. No.) on either Form W-2 (Copy A) or Form W-3.

(13) Do not print the checkboxes in:

- Box (b) of Form W-3. The "X" should be programmed to be printed and centered directly below the applicable "Kind of Payer."
- The "Void" box of Form W-2 (Copy A). The "X" should be programmed to be printed to the right of "Void" because of space limitations.
- Box 13 of Form W-2 (Copy A). The "X" should be programmed to be printed and centered directly below the applicable box title.

(14) Do not print dollar signs. If there are no money amounts being reported, the entire field should be left blank.

(15) The space between the two Forms W-2 (Copy A) is 1.33 inches.

.02 You must submit samples of your laser-printed substitute forms to the SSA. Only laser-printed, black-and-white substitute Forms W-2 (Copy A) and W-3 for tax year 2007 will be accepted for approval by the SSA. Questions regarding other forms (that is, red-ink Forms W-2c, W-3c, 1099 series, 1096, etc.) must be directed to the IRS.

.03 You will be required to send one set of blank and one set of dummy-data, laser-printed substitute Forms W-2 (Copy A) and W-3 for approval. Sample data entries should be filled in to the maximum length for each box entry, preferably using numeric data or alpha data, depending upon the type required to be entered. Include in your submission the name, telephone number, fax number, and email address of a contact person who can answer questions regarding your sample forms.

.04 To receive approval, you may first contact the SSA at *laser.forms@ssa.gov* to obtain a template and further instructions in PDF or Excel format. You may also send your 2007 sample, laser-printed substitute forms to:

Social Security Administration
Data Operations Center
Attn: Laser Forms Approval, Room 235
1150 E. Mountain Drive
Wilkes-Barre PA 18702-7997

Send your sample forms via private mail carrier or certified mail in order to verify their receipt. You can expect approval (or disapproval) by the SSA within 30 days of receipt of your sample forms.

.05 The 4-digit vendor code preceded by four zeros and a slash (0000/) must be preprinted on the sample, laser-printed substitute forms. Forms not containing a vendor code will be rejected and will not be submitted for testing or approval. If you do not have a vendor code, you may contact the National Association of Computerized Tax Processors via email at *president@nactp.org*.

.06 If you use forms produced by a vendor and have questions concerning approval, do not send the forms to the SSA for approval. Instead, you may contact the software vendor to obtain a copy of SSA's dated approval notice supplied to that vendor.

Section 2. Requirements for Substitute Forms Furnished to Employees (Copies B, C, and 2 of Form W-2)

Note. Printers are cautioned that the **rules in Part B, Section 2 (this section), apply only to employee copies of Form W-2 (Copies B, C, and 2).** Paper filers who send Forms W-2 (Copy A) to the SSA must follow the requirements in Part B, Sections 1A and/or 1B above.

.01 All employers (including those who file electronically) must furnish employees with at least two copies of Form W-2 (three or more for employees required to file a state, city, or local income tax return). The following rules are guidelines for preparing employee copies.

The dimensions of these copies (Copies B, C, and 2), but not Copy A, may differ from the dimensions of the official IRS form to allow space for reporting additional information, including additional entries such as withholding for health insurance, union dues, bonds, or charity in box 14. The limitation of a maximum of four items in box 12 of Form W-2 applies only to Copy A, which is filed with the SSA.

Note. Payee statements (Copies B, C, and 2 of Form W-2) may be furnished electronically if employees give their consent (as described in Treasury Regulations Section 31.6051–1(j)). See also Publication 15-A, Employer's Supplemental Tax Guide.

.02 The minimum dimensions for employee copies only (not Copy A) of Form W-2 should be 2.67 inches deep by 4.25 inches wide. The maximum dimensions should be no more than 6.5 inches deep by no more than 8.5 inches wide.

Note. The maximum and minimum size specifications are for tax year 2007 only and may change in future years.

.03 Either horizontal or vertical format is permitted (see Exhibit D).

.04 The paper for all copies must be white and printed in black ink. The substitute Copy B, which employees are instructed to attach to their federal income tax returns, should be at least 9-pound paper (basis 17 x 22-500). Other copies furnished to employees should also be at least 9-pound paper (basis 17 x 22-500).

.05 Employee copies of Form W-2 (Copies B, C, and 2), including those that are printed on a single sheet of paper, must be easily separated. Providing perforations between the individual copies satisfies this requirement, but using scissors to separate Copies B, C, and 2 does not.

Note. The perforation requirement in this section does not apply to printouts of copies of Forms W-2 that are furnished electronically to employees (as described in Treasury Regulations Section 31.6051–1(j)). However, these employees should be cautioned to carefully separate the copies of Form W-2. See Publication 15-A, Employer's Supplemental Tax Guide, for information on electronically furnishing Forms W-2 to employees.

.06 Interleaved carbon and chemical transfer paper employee copies must be clearly legible. Hot wax and cold-carbon spots are not permitted for employee copies. All copies must be able to be photocopied. Interleaved carbon should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

.07 The electronic tax logo on the IRS official employee copies is not required on any of the substitute form copies. To avoid confusion and questions by employees, employers are encouraged to delete the identifying number ("22222") and the word "Void" and its associated checkbox from the employee copies of Form W-2.

.08 All substitute employee copies must contain boxes, box numbers, and box titles that match the official IRS Form W-2. Boxes that do not apply can be deleted. However, certain core boxes must be included. The placement, numbering, and size of this information is specified as follows:

- The items and box numbers that constitute the core data are:

  Box 1 — Wages, tips, other compensation,

  Box 2 — Federal income tax withheld,

Box 3 — Social security wages,

Box 4 — Social security tax withheld,

Box 5 — Medicare wages and tips, and

Box 6 — Medicare tax withheld.

The core boxes must be printed in the exact order shown on the official IRS form.

- The core data boxes (1 through 6) must be placed in the upper right of the form. Substitute vertical-format copies may have the core data across the top of the form (see Exhibit D). In no instance, will boxes or other information be permitted to the right of the core data.

- The form title, number, or copy designation (B, C, or 2) may be at the top of the form. Also, a reversed or blocked-out area to accommodate a postal permit number or other postal considerations is allowed in the upper-right.

- Boxes 1 through 6 must each be a minimum of 1 1/8 inches wide x 1/4 inch deep.

- Other required boxes are:

  a) Employee's social security number,

  b) Employer identification number (EIN),

  c) Employer's name, address, and ZIP code,

  e) Employee's name, and

  f) Employee's address and ZIP code.

Identifying items must be present on the form and be in boxes similar to those on the official IRS form. However, they may be placed in any location other than the top or upper right. You do not need to use the lettering system (a-c, e-f) used on the official IRS form. The employer identification number (EIN) may be included with the employer's name and address and not in a separate box.

Note. Box d ("Control number") is not required.

.09 All copies of Form W-2 furnished to employees must clearly show the form number, the form title, and the tax year prominently displayed together in one area of the form. The title of Form W-2 is "Wage and Tax Statement." It is recommended (but not required) that this be located on the bottom left of substitute Forms W-2. The reference to the "Department of the Treasury — Internal Revenue Service" must be on all copies of substitute Forms W-2 furnished to employees. It is recommended (but not required) that this be located on the bottom right of Form W-2.

.10 If the substitute employee copies are labeled, the forms must contain the applicable description:

- "Copy B, To Be Filed With Employee's FEDERAL Tax Return."

- "Copy C, For EMPLOYEE'S RECORDS."

- "Copy 2, To Be Filed With Employee's State, City, or Local Income Tax Return."

It is recommended (but not required) that these be located on the lower left of Form W-2. If the substitute employee copies are not labeled as to the disposition of the copies, then written notification using similar wording must be provided to each employee.

.11 The tax year (2007) must be clearly printed on all copies of substitute Form W-2. It is recommended (but not required) that this information be in the middle at the bottom of the Form W-2. The use of 24-pt. OCR-A font is recommended (but not required).

.12 Boxes 1, 2, and 9 (if applicable) on Copy B must be outlined in bold 2-point rule or highlighted in some manner to distinguish them. If "Allocated tips" are being reported, it is recommended (but not required) that box 8 also be outlined. If reported, "Social security tips" (box 7) must be shown separately from "Social security wages" (box 3).

Note. Boxes 8 and 9 may be omitted if not applicable.

.13 If employers are required to withhold and report state or local income tax, the applicable boxes are also considered core information and must be placed at the bottom of the form. State information is included in:

- Box 15 (State, Employer's state ID number)

- Box 16 (State wages, tips, etc.)
- Box 17 (State income tax)
  Local information is included in:
- Box 18 (Local wages, tips, etc.)
- Box 19 (Local income tax)
- Box 20 (Locality name)

.14 Boxes 7 through 14 may be omitted from substitute employee copies unless the employer must report any of that information to the employee. For example, if an employee did not have "Social security tips" (box 7), the form could be printed without that box. But if an employer provided dependent care benefits, the amount must be reported separately, shown in box 10, and labeled "Dependent care benefits."

.15 Employers may enter more than four codes in box 12 of substitute Copies B, C, and 2 (and 1 and D) of Form W-2, but each entry must use Codes A-BB (see the 2007 Instructions for Forms W-2 and W-3).

.16 If an employer has employees in any of the three categories in box 13, all checkbox headings must be shown and the proper checkmark made, when applicable.

.17 Employers may use box 14 for any other information that they wish to give to their employees. Each item must be labeled. (See the instructions for box 14 in the 2007 Instructions for Forms W-2 and W-3.)

.18 The front of Copy C of a substitute Form W-2 must contain the note "This information is being furnished to the Internal Revenue Service. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable and you fail to report it."

.19 Instructions similar to those contained on the back of Copies B, C, and 2 of the official IRS Form W-2 must be provided to each employee. An employer may modify or delete instructions that do not apply to its employees. (For example, remove Railroad Retirement Tier 1 and Tier 2 compensation information for nonrailroad employees or information about dependent care benefits that the employer does not provide.)

.20 Employers must notify their employees who have no income tax withheld that they may be able to claim a tax refund because of the earned income credit (EIC). They will meet this notification requirement if they furnish a substitute Form W-2 with the EIC notice on the back of Copy B, IRS Notice 797, Possible Federal Tax Refund Due to the Earned Income Credit (EIC), or on their own statement containing the same wording. They may also change the font on Copies B, C, and 2 so that the EIC notification and Form W-2 instructions fit differently. For more information about notification requirements, see Notice 1015, Have You Told Your Employees About the Earned Income Credit (EIC)?

Note. An employer does not have to notify any employee who claimed exemption from withholding on Form W-4, Employee's Withholding Allowance Certificate, for the calendar year.

Part C. Additional Instructions

Section 1. Additional Instructions for Form Printers

.01 If electronic media is not used for filing with the SSA, the substitute copies of Forms W-2 (either red-ink or laser-printed) should be assembled in the same order as the official IRS Forms W-2. Copy A should be first, followed sequentially by perforated sets (Copies 1, B, C, 2, and D).

.02 The substitute form to be filed by the employer with the SSA must carry the designation "Copy A."

Note. Electronic filers do not submit either red-ink or laser-printed paper Form W-2 (Copy A) or Form W-3 to the SSA.

.03 Substitute forms (red-ink or laser-printed) do not require a copy to be retained by employers (Copy D of Form W-2). However, employers must be prepared to verify or duplicate the information if it is requested by the IRS or the SSA. Paper filers who do not keep a Form W-2 (Copy D) should be able to generate a facsimile of Form W-2 (Copy A) in case of loss.

.04 Except for copies in the official assembly, no additional copies that may be prepared by employers should be placed ahead of Form W-2 (Copy C) "For EMPLOYEE'S RECORDS."

.05 You must provide instructions similar to those contained on the back of Copies B, C, and 2 of the official IRS Form W-2 to each employee. You may print them on the back of the substitute Copies B, C, and 2 or provide them to employees on a separate statement. You do not need to use the back of Copy 2. If you do not use Copy 2, you may include all the information, which is on the back of the official Copies B, C, and 2, on the back of your substitute Copies B and C only. As an example, you may use the "Note" on the back of the official Copy C as the dividing point between the text for your substitute Copies B and C. Do not print these instructions on the back of Copy 1. Any Forms W-2 (Copy A) and W-3 that are filed with the SSA must have no printing on the reverse side.

Section 2. Instructions for Employers

.01 Only originals of Form W-2 (Copy A) and Form W-3 may be filed with the SSA. Carbon copies and photocopies are unacceptable.

.02 Employers should type or machine-print data entries on the non-laser-generated forms whenever possible. Ensure good quality by using a high-quality type face, inserting data in the middle of blocks that are well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images. Black ink must be used with no script type, inverted font, italics or dual-case alpha characters.

Note. 12-point Courier font is preferred by the SSA.

.03 Form W-2 (Copy A) requires decimal entries for wage data. Dollar signs should not be printed with money amounts on the Forms W-2 (Copy A) and W-3.

.04 The employer must provide a machine-scannable Form W-2 (Copy A). The employer must also provide employee copies (Copies B, C, and 2) that are legible and able to be photocopied (by the employee). Do not print any data in the top margin of the payee copies of the forms.

.05 Any printing in box d (Control number) on Form W-2 or box a on Form W-3 may not touch any vertical or horizontal lines and should be centered in the box.

.06 The filer's employer identification number (EIN) must be entered in box b of Form W-2 and box e of Form W-3. The EIN entered on Form(s) W-2 (box b) and Form W-3 (box e) must be the same as on Forms 941, 943, 944, CT-1, Schedule H (Form 1040), or any other corresponding forms filed with the IRS. Be sure to use EIN format (00-0000000) rather than SSN format (000-00-0000).

.07 The employer's name, address, and EIN may be preprinted.

.08 If available, employers should use the official IRS-preprinted Form W-3 that they received with Publication 393 or Publication 2184 when filing red-ink Forms W-2 (Copy A) with the SSA.

Section 3. OMB Requirements for Both Red-Ink and Laser-Printed Substitute Forms

.01 The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires the following:

- The Office of Management and Budget (OMB) approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in or near the upper right corner) the OMB approval number, if assigned. (The official OMB numbers may be found on the official IRS printed forms and are also shown on the forms in Exhibits A, B, C, E, and F.)
- Each IRS form (or its instructions) states:

  (1) Why the IRS needs the information,

  (2) How it will be used, and

  (3) Whether or not the information is required to be furnished to the IRS.

.02 This information must be provided to any users of official or substitute IRS forms or instructions.

.03 The OMB requirements for substitute IRS Form W-2 (Copy A) and Form W-3 are the following.

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- The OMB number (1545-0008) must appear exactly as shown on the official IRS form.
- For any copy of Form W-2 other than Copy A, the OMB number must use one of the following formats:

  (1) OMB No. 1545-0008 (preferred) or

  (2) OMB # 1545-0008 (acceptable).

.04 Any substitute Form W-2 (Copy A only) must state "For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D." Any substitute Form W-3 must state "For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D of Form W-2." If no instructions are provided to users of your forms, you must furnish them with the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 4. Reproducible Copies of Forms

.01 You can obtain official IRS forms and information copies of federal tax materials at local IRS offices or by calling the IRS Distribution Center at 1-800-829-3676. Other ways to get federal tax material include the following.

- The IRS website at *www.irs.gov*.
- The IRS' CD (Publication 1796).

Only contact the IRS, not the SSA, for IRS forms.

Note. Many IRS forms are provided on the IRS website and on the Federal Tax Forms CD. But copies of Form W-2 (Copy A) and Form W-3 cannot be used for filing with the IRS or SSA when obtained by these methods because the forms do not meet the specific printing specifications as described in this publication. Copies of Forms W-2 and W-3 obtained from these sources are for information purposes only.

.02 The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its Federal Tax Forms CD. The CD will be available for the upcoming filing season. Order Publication 1796, IRS Federal Tax Products CD, by using the IRS website at *www.irs.gov/cdorders* or by calling 1-877-CDFORMS (1-877-233-6767).

Section 5. Effect on Other Documents

.01 Revenue Procedure 2006-55, 2006-52 I.R.B. 1151, dated December 26, 2006 (reprinted as Publication 1141, Revised 12-2006), is superseded.

List of Exhibits

Exhibit A — Form W-2 (Copy A) (Red-Ink)

Exhibit B — Form W-3 (Red-Ink)

Exhibit C — Form W-2 (Copy B)

Exhibit D — Form W-2 (Alternative Employee Copies) (Illustrating Horizontal and Vertical Formats)

Exhibit E — Form W-2 (Copy A) (Laser-Printed)

Exhibit F — Form W-3 (Laser-Printed)

Exhibit A Form W-2 (Copy A)

(Red-Ink)

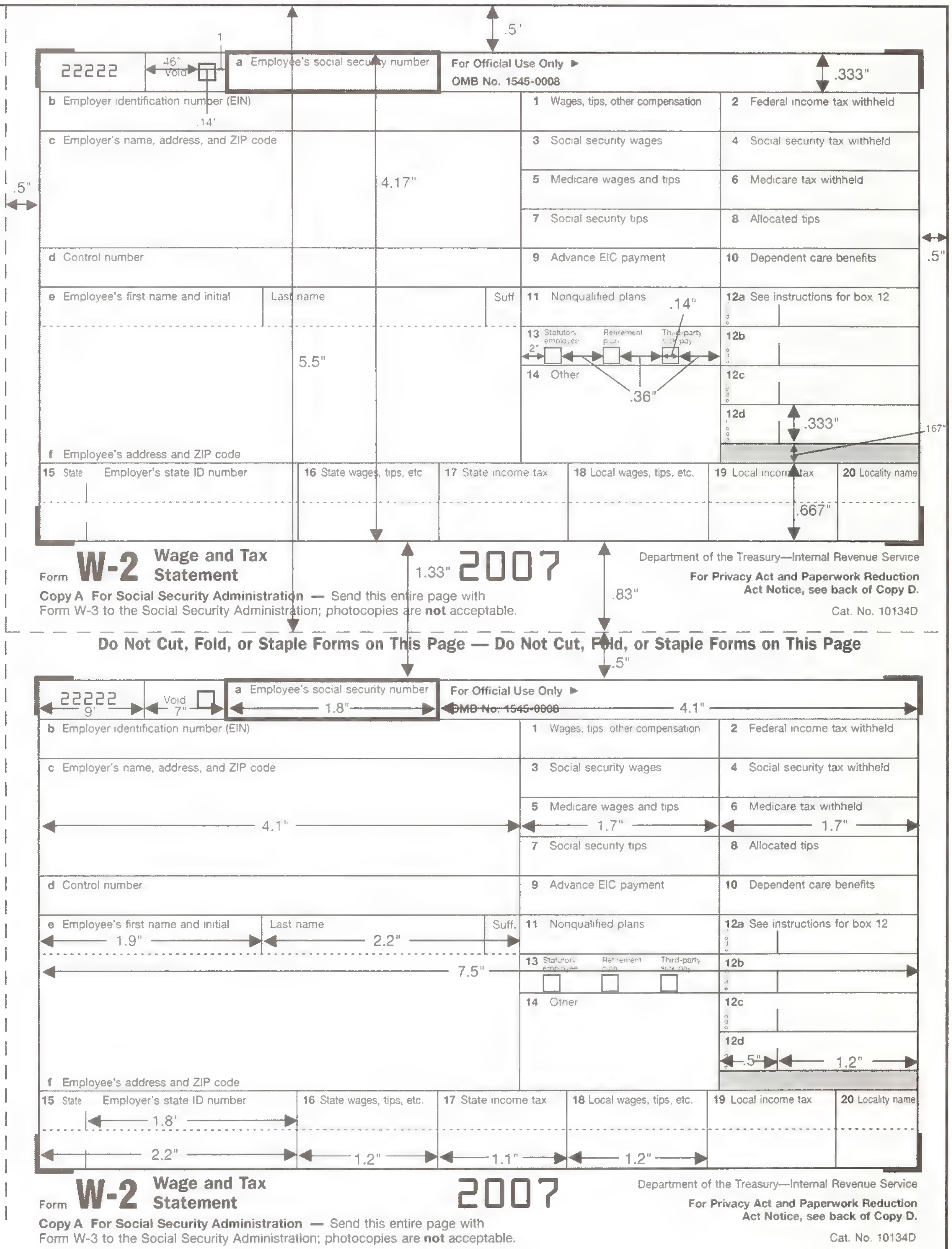

Exhibit B Form W-3

(Red-Ink)

.5"

DO NOT STAPLE

33333 .85"	a Control number 1.65"	For Official Use Only ▶ OMB No. 1545-0008 5.0"

b Kind of Payer 1.1" — 941, Military, 943, .14", 944; CT-1 .36", Hshld emp .36", Medicare govt. emp .46", Third-party sick pay .36"	1 Wages, tips, other compensation	2 Federal income tax withheld
	3 Social security wages	4 Social security tax withheld
c Total number of Forms W-2 1.6" / d Establishment number 1.6"	5 Medicare wages and tips	6 Medicare tax withheld
e Employer identification number (EIN) 3.2"	7 Social security tips 2.15"	8 Allocated tips 2.15"
f Employer's name 7.5"	9 Advance EIC payments	10 Dependent care benefits
	11 Nonqualified plans 4.67"	12 Deferred compensation
.5"	13 For third-party sick pay use only .333"	
g Employer's address and ZIP code	14 Income tax withheld by payer of third-party sick pay	
h Other EIN used this year		
15 State .6" Employer's state ID number 2.6"	16 State wages, tips, etc.	17 State income tax
	18 Local wages, tips, etc.	19 Local income tax
Contact person	Telephone number ( )	For Official Use Only .667"
Email address	Fax number ( )	

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

5.83" .8" 11.0"

Signature ▶ Title ▶ Date ▶

Form **W-3 Transmittal of Wage and Tax Statements** 2007 Department of the Treasury Internal Revenue Service

Send this entire page with the entire Copy A page of Form(s) W-2 to the Social Security Administration. Photocopies are not acceptable.

Do not send any payment (cash, checks, money orders, etc.) with Forms W-2 and W-3.

What's New

Relocation of form ID on Form W-3. For consistency with the revisions to Form W-2, we relocated the form ID number ("33333") to the top left corner of Form W-3.

Reminder

Separate instructions. See the 2007 Instructions for Forms W-2 and W-3 for information on completing this form.

Purpose of Form

Use Form W-3 to transmit Copy A of Form(s) W-2, Wage and Tax Statement. Make a copy of Form W-3 and keep it with Copy D (For Employer) of Form(s) W-2 for your records. Use Form W-3 for the correct year. **File Form W-3 even if only one Form W-2 is being filed.** If you are filing Form(s) W-2 electronically, **do not** file Form W-3.

When To File

File Form W-3 with Copy A of Form(s) W-2 by February 29, 2008.

Where To File

Send this entire page with the entire Copy A page of Form(s) W-2 to:

Social Security Administration
Data Operations Center
Wilkes-Barre, PA 18769-0001

Note. If you use "Certified Mail" to file, change the ZIP code to "18769-0002." If you use an IRS-approved private delivery service, add "ATTN: W-2 Process, 1150 E. Mountain Dr." to the address and change the ZIP code to "18702-7997." See Publication 15 (Circular E), Employer's Tax Guide, for a list of IRS-approved private delivery services.

5.03"

For Privacy Act and Paperwork Reduction Act Notice, see the back of Copy D of Form W-2.

Exhibit C
Form W-2
(Copy B)

a Employee's social security number	OMB No. 1545-0008	Safe, accurate, FAST! Use IRS e-file. Visit the IRS website at *www.irs.gov/efile*
b Employer identification number (EIN)	1 Wages, tips, other compensation	2 Federal income tax withheld
c Employer's name, address, and ZIP code	3 Social security wages	4 Social security tax withheld
	5 Medicare wages and tips	6 Medicare tax withheld
	7 Social security tips	8 Allocated tips
d Control number	9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Last name Suff.	11 Nonqualified plans	12a See instructions for box 12 (Code)
	13 Statutory employee / Retirement plan / Third-party sick pay	12b (Code)
	14 Other	12c (Code)
f Employee's address and ZIP code		12d (Code)

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage and Tax Statement** **2007** Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

Exhibit D Form W-2 Alternative Employee Copies

(Illustrating Horizontal and Vertical Formats)

Form W-2 Wage and Tax Statement

a Employee's social security number	1 Wages, tips, other compensation	2 Federal income tax withheld
b Employer identification number (EIN)	3 Social security wages	4 Social security tax withheld
c Employer's name, address, and Zip code	5 Medicare wages and tips	6 Medicare tax withheld
e Employee's name		
f Employee's address and ZIP code		

15 State Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Copy C For EMPLOYEE'S RECORDS. 2007 Department of the Treasury—Internal Revenue Service

Horizontal Format

1 Wages, tips, other compensation	2 Federal income tax withheld
3 Social security wages	4 Social security tax withheld
5 Medicare wages and tips	6 Medicare tax withheld
Employee's social security number	
Employer identification number (EIN)	
Employer's name, address and, ZIP code	
Employee's name Employee's address and ZIP code	
15 State Employer's state ID number	18 Local wages, tips, etc.
16 State wages, tips, etc.	19 Local income tax
17 State income tax	20 Locality name
Copy B To Be Filed With Employee's FEDERAL Tax Return.	

Form W-2 Wage and Tax Statement 2007 Department of the Treasury—Internal Revenue Service

Vertical Format

Note: Exhibit D provides examples of employee copies of Form W-2 only. For examples of Copy A, see Exhibit A or Exhibit E. For the specifications of Copy A, which must be filed with the SSA, see Part B, sections 1A and 1B.

The core data boxes are 1 through 6 and, if applicable, 15 through 20. The core data must be similarly positioned, exactly numbered, and exactly titled as shown for each format. Other data may be placed in unoccupied areas based upon the employer's needs. Form identification may be placed before or after the core data. However, the employer's non-core elements may be positioned only between the sections of core data.

Exhibit E
Form W-2 (Copy A)

(Laser-Printed)

This form may be subject to change.

22222	Void	a Employee's social security number	For Official Use Only ▶ OMB No. 1545-0008

b Employer identification number (EIN)	1 Wages, tips, other compensation	2 Federal income tax withheld
c Employer's name, address, and ZIP code	3 Social security wages	4 Social security tax withheld
	5 Medicare wages and tips	6 Medicare tax withheld
	7 Social security tips	8 Allocated tips
d Control number	9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial / Last name / Suff	11 Nonqualified plans	12a See instructions for box 12
	13 Statutory employee / Retirement plan / Third-party sick pay	12b
	14 Other	12c
		12d
f Employee's address and ZIP code		

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage & Tax Statement** 2007 0000/0000

Department of the Treasury—Internal Revenue Service

For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.

Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Do Not Cut, Fold, or Staple Forms on This Page

22222	Void	a Employee's social security number	For Official Use Only ▶ OMB No. 1545-0008

b Employer identification number (EIN)	1 Wages, tips, other compensation	2 Federal income tax withheld
c Employer's name, address, and ZIP code	3 Social security wages	4 Social security tax withheld
	5 Medicare wages and tips	6 Medicare tax withheld
	7 Social security tips	8 Allocated tips
d Control number	9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial / Last name / Suff	11 Nonqualified plans	12a See instructions for box 12
	13 Statutory employee / Retirement plan / Third-party sick pay	12b
	14 Other	12c
		12d
f Employee's address and ZIP code		

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage & Tax Statement** 2007 0000/0000

Department of the Treasury—Internal Revenue Service

For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.

Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.

Exhibit F

Form W-3

(Laser-Printed)

This form may be subject to change.

.5"

33333 .85"	a Control number 1.65"	For Official Use Only ▶ OMB No. 1545-0008 5.0"

.5"

b Kind of Payer — 941, Military, 943, 944; CT-1, Hshld. emp., Medicare govt. emp., Third-party sick pay — 3.2"	1 Wages, tips, other compensation	2 Federal income tax withheld
	3 Social security wages	4 Social security tax withheld
c Total number of Forms W-2 1.6" — d Establishment number 1.6"	5 Medicare wages and tips	6 Medicare tax withheld
e Employer identification number (EIN) 3.2"	7 Social security tips 2.15"	8 Allocated tips 2.15"
f Employer's name 7.5"	9 Advance EIC payments	10 Dependent care benefits
4.67"	11 Nonqualified plans	12 Deferred compensation
	13 For third-party sick pay use only	
g Employer's address and ZIP code	14 Income tax withheld by payer of third-party sick pay	
h Other EIN used this year		
15 State — Employer's state ID number	16 State wages, tips, etc.	17 State income tax
	18 Local wages, tips, etc.	19 Local income tax
Contact person	Telephone number ( )	For Official Use Only
Email address	Fax number ( )	0000/0000

.5"

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

.8"

Signature ▶ Title ▶ Date ▶

Form **W-3 Transmittal of Wage and Tax Statements** 2007 Department of the Treasury Internal Revenue Service

Send this entire page with the entire Copy A page of Form(s) W-2 to the Social Security Administration. Photocopies are not acceptable.

Do not send any payment (cash, checks, money orders, etc.) with Forms W-2 and W-3.

What's New

5.03"

Relocation of form ID on Form W-3. For consistency with the revisions to Form W-2, we relocated the form ID number ("33333") to the top left corner of Form W-3.

Reminder

Separate instructions. See the 2007 Instructions for Forms W-2 and W-3 for information on completing this form.

Purpose of Form

Use Form W-3 to transmit Copy A of Form(s) W-2, Wage and Tax Statement. Make a copy of Form W-3 and keep it with Copy D (For Employer) of Form(s) W-2 for your records. Use Form W-3 for the correct year. **File Form W-3 even if only one Form W-2 is being filed.** If you are filing Form(s) W-2 electronically, **do not** file Form W-3.

When To File

File Form W-3 with Copy A of Form(s) W-2 by February 29, 2008.

Where To File

Send this entire page with the entire Copy A page of Form(s) W-2 to:

Social Security Administration
Data Operations Center
Wilkes-Barre, PA 18769-0001

Note. If you use "Certified Mail" to file, change the ZIP code to "18769-0002." If you use an IRS-approved private delivery service, add "ATTN: W-2 Process, 1150 E. Mountain Dr." to the address and change the ZIP code to "18702-7997." See Publication 15 (Circular E), Employer's Tax Guide, for a list of IRS-approved private delivery services.

For Privacy Act and Paperwork Reduction Act Notice, see the back of Copy D of Form W-2.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355–3: Active conduct of a trade or business.

Section 355. Using different scenarios, this ruling addresses whether a corporation that holds a membership interest in a limited liability company that is classified as a partnership for federal tax purposes is engaged in the active conduct of a trade or business for purposes of section 355(b) of the Code. Rev. Rul. 92–17 modified.

Rev. Rul. 2007–42

ISSUE(S)

Under the facts described below, is a corporation (D) that owns a membership interest in a limited liability company (LLC) classified as a partnership for Federal tax purposes engaged in the active conduct of a trade or business for purposes of § 355(b) of the Internal Revenue Code?

FACTS

Situation 1.

LLC is a domestic limited liability company that has been classified as a partnership for Federal tax purposes since its date of organization. For more than five years, LLC has owned several commercial office buildings that are leased to unrelated third parties. LLC has one class of membership interests outstanding. For more than five years, D has owned a 33⅓-percent membership interest in LLC, and has owned all the stock of a subsidiary (C), a corporation that has been engaged for more than five years in the active conduct of a trade or business that is unrelated to D's activities.

LLC continuously seeks additional properties to expand its rental business. When a property is located, LLC negotiates its purchase and financing and determines whether renovations or alterations are necessary to make the building suitable for rental. LLC periodically repaints and refurbishes its existing properties.

Pursuant to the terms of its leases, LLC provides day-to-day upkeep and maintenance services for its office buildings. These services include trash collection, ground maintenance, electrical and plumbing repair, and insect control. Additionally, LLC advertises for new tenants, verifies information contained in lease applications, negotiates leases, handles tenant complaints, prepares eviction notices and warnings for delinquent tenants, collects rent, and pays all expenses, including gas, water, sewage, electricity and insurance for the office buildings. LLC also maintains financial and accounting records to reflect income and expenses relating to each of its rental properties as well as LLC's general expenses.

The above described activities of LLC have been conducted for more than five years. The employees of LLC perform all management and operational functions with respect to LLC*'s* rental business. Neither D nor any other member of LLC performs services with respect to LLC's business.

For a valid business purpose, D proposes to distribute all its C stock *pro rata* to D's shareholders in a transaction intended to satisfy the requirements of § 355.

Except for the issue of whether D is engaged in the active conduct of a trade or business under § 355(b), the transaction will otherwise meet all the requirements of § 355.

Situation 2.

The facts are the same as *Situation 1* except that D owns a 20-percent membership interest in LLC.

LAW AND ANALYSIS

Section 355(a) provides that, under certain circumstances, a corporation may distribute stock or securities in a corporation it controls to its shareholders or security holders in a transaction that is nontaxable to such shareholders or security holders. Sections 355(a)(1)(C) and 355(b) require that both the distributing and controlled corporations be engaged, immediately after the distribution, in the active conduct of a trade or business that has been actively conducted throughout the five-year period ending on the date of distribution.

Section 1.355–3(b)(2)(ii) of the Income Tax Regulations, in defining "trade or business" for purposes of § 355, provides that a corporation is treated as engaged in a trade or business immediately after the distribution if a specific group of activities are being carried on by the corporation for the purpose of earning income or profit, and the activities included in such group include every operation that forms a part of, or a step in, the process of earning income or profit. Such group of activities ordinarily must include the collection of income and the payment of expenses.

Section 1.355–3(b)(2)(iii) provides that the determination whether a trade or business is actively conducted will be made from all the facts and circumstances. Generally, for a trade or business to be actively conducted, the corporation is required itself to perform active and substantial management and operational functions. Generally, activities performed by the corporation itself do not include activities performed by persons outside the corporation, including independent contractors. A corporation may, however, satisfy the active trade or business test through the activities that it performs itself, even though some of its activities are performed by others.

Under § 1.355–3(b)(2)(iv), the active conduct of a trade or business does not include the holding of property for investment purposes. It also does not include the ownership and operation (including leasing) of property used in a trade or business, unless the owner performs significant services with respect to the operation and management of the property.

The fact that a partnership engages in activities that would constitute the active conduct of a trade or business if conducted by a corporation does not necessarily mean that each partner in the partnership is considered to be engaged in the active conduct of a trade or business for purposes of § 355(b). In such a case, the determination of whether a partner is considered to be engaged in the active conduct of a trade or business must be based on the requirements of § 355 and the regulations thereunder taking into account the activities of the partner (if any), the partner's interest in the partnership, and the activities of the partnership.

Rev. Rul. 92–17, 1992–1 C.B. 142, considers whether D, a corporate general partner in a limited partnership, is engaged in the active conduct of a trade or business within the meaning of § 355(b). For more than five years, D owned a 20-percent interest in LP, a limited partnership that owned several commercial office buildings leased to unrelated third parties. D's officers performed active and substantial management functions with respect to LP, including the significant business decision-making of the partnership, and regularly participated in the overall supervision, direction, and control of LP's employees in operating LP's rental business. Rev. Rul. 92–17 concludes that D is engaged in the active conduct of a trade or business within the meaning of § 355(b). Rev. Rul. 2002–49, 2002–2 C.B. 288, reaches a similar conclusion where D and another corporation (X) each own a 20-percent interest in a member-managed LLC that is classified as a partnership for Federal tax purposes and D and X jointly manage the LLC's business.

By comparison, § 1.368–1(d)(4)(iii)(B), regarding the continuity of business enterprise requirement applicable to corporate reorganizations, provides that the issuing corporation will be treated as conducting a business of a partnership if members of the qualified group, in the aggregate, own an interest in the partnership representing a significant interest in that partnership business. Those regulations indicate that a one-third interest in the partnership represents a significant interest in the partnership business, and a corporation that owns such interest but does not perform active and substantial management functions for the business of the partnership is nevertheless treated as conducting the business of the partnership.

In *Situation 1*, D is engaged in the active conduct of LLC's rental business for purposes of § 355(b) because D owns a significant interest in LLC and LLC performs the required activities that constitute an active trade or business under the regulations.

In *Situation 2*, D is not engaged in the active conduct of LLC's rental business for purposes of § 355(b) because D neither owns a significant interest in LLC nor performs active and substantial management functions for LLC.

HOLDING

In *Situation 1*, D is engaged in the active conduct of a trade or business for purposes of § 355(b).

In *Situation 2*, D is not engaged in the active conduct of a trade or business for purposes of § 355(b).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92–17 is modified to the extent it indicated that a partner must perform management functions in order for the partner to be treated as engaged in the active conduct of the trade or business of the partnership.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Russell P. Subin and Rubin B. Ranat of the office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Subin at (202) 622–7790 or Mr. Ranat at (202) 622–7530 (not toll-free calls).

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(b)–1: Certain retroactive changes in plan.

The timing of submissions for individually designed and pre-approved qualified pension, profit-sharing and stock bonus plans is described. See Rev. Proc. 2007-44, page 54.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)–2: Termination or partial termination; discontinuance of contributions.

Section 411(d)(3); partial termination; turnover. This ruling holds that based on its facts and circumstances, there is a presumption of a partial termination within the meaning of section 411(d)(3) of the Code where the turnover rate for employees participating in the qualified plan is at least 20 percent.

Rev. Rul. 2007–43

ISSUE

Is there a partial termination of a plan under § 411(d)(3) of the Internal Revenue Code under the facts described in this revenue ruling?

FACTS

Employer X maintains Plan A, a defined contribution plan qualified under § 401(a). The plan year for Plan A is the calendar year. The plan participants include both current and former employees. Plan A provides that an employee of Employer X has a fully vested and nonforfeitable interest in his or her account balance upon either completion of 3 years of service or attainment of age 65. The plan also provides for each participant to have a fully vested and nonforfeitable right to his or her account balance upon the plan's termination or upon a partial termination of the plan that affects the participant.

Employer X ceases operations at one of its four business locations. As a result, 23 percent of the Plan A participants who are employees of Employer X cease active participation in Plan A due to a severance

from employment (excluding any severance from employment that is either on account of death or disability, or retirement on or after normal retirement age) during the plan year. Some of these participants are fully vested due to having completed 3 years of service or having attained age 65. Plan A is not terminated.

LAW

Section 411(d)(3) provides in relevant part that a plan will not be qualified unless the plan provides that, upon its partial termination, the rights of all affected employees to benefits accrued to the date of such partial termination, to the extent funded on that date, or the amounts credited to their accounts, are nonforfeitable.

Section 1.411(d)–2(b)(1) of the Income Tax Regulations provides that whether or not a partial termination of a qualified plan occurs (and the time of such event) is determined by the Commissioner with regard to all the facts and circumstances in a particular case. The facts and circumstances include the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan, as well as plan amendments that adversely affect the rights of employees to vest in benefits under the plan.

Section 1.411(d)–2(b)(2) provides a special rule with respect to a defined benefit plan that ceases or decreases future benefit accruals under the plan. A partial termination is deemed to occur if a potential reversion to the employer maintaining the plan is created or increased as a result of such cessation or decrease. This special rule does not apply to defined contribution plans.

Section 1.411(d)–2(b)(3) provides that, if a termination occurs, § 411(d)(3) only applies to the part of the plan that is terminated.

In Rev. Rul. 73–284, 1973–2 C.B. 139, an employer established a qualified pension plan that covered all of its 15 employees. The employer later acquired a new business location 100 miles away and closed the original one. All employees were given the opportunity to transfer to the new location and continue to participate in the plan, but only 3 chose to do so. The other 12 employees were discharged and their participation under the plan ended. The employer hired replacements for them at the new location. The revenue ruling concludes that there was a partial termination due to the termination of these employees in connection with the change in business location.

In Rev. Rul. 81–27, 1981–1 C.B. 228, the employer established a qualified defined benefit pension plan that covered employees in the two divisions of its businesses. The plan covered 165 employees. The employer closed down one division and terminated 95 participants. The revenue ruling concludes that the discharge by the employer of 95 of 165 participants constituted a partial termination.

Weil v. Terson Co. Retirement Plan Administrative Committee, 933 F.2d 106 (2d Cir. 1991), holds that the turnover rate in both vested and nonvested participants is taken into account in determining whether there has been a reduction in the workforce that constitutes a partial termination for purposes of § 411(d)(3). *See* 933 F.2d at 110.

Matz v. Household International Tax Reduction Investment Plan, 388 F.3d 570 (7^{th} Cir. 2004), holds that there is a rebuttable presumption that a 20 percent or greater reduction in plan participants is a partial termination for purposes of § 411(d)(3). The court holds that this presumption is rebuttable depending on other facts and circumstances. *See* 388 F.3d at 578. The court, relying on *Weil*, bases the 20 percent calculation on the ratio of those participants who lose coverage, whether or not vested, to all participants, whether or not vested.

ANALYSIS

Based on the foregoing, whether a partial termination of a plan under § 411(d)(3) has occurred depends on the facts and circumstances, including the extent to which participating employees have had a severance from employment. If the turnover rate is at least 20 percent, there is a presumption that a partial termination of the plan has occurred. The turnover rate is determined by dividing the number of participating employees who had an employer-initiated severance from employment during the applicable period by the sum of all of the participating employees at the start of the applicable period and the employees who became participants during the applicable period. The applicable period depends on the circumstances: the applicable period is a plan year (or, in the case of a plan year that is less than 12 months, the plan year plus the immediately preceding plan year) or a longer period if there are a series of related severances from employment.

All participating employees are taken into account in calculating the turnover rate, including vested as well as nonvested participating employees. Employer-initiated severance from employment generally includes any severance from employment other than a severance that is on account of death, disability, or retirement on or after normal retirement age. An employee's severance from employment is employer-initiated even if caused by an event outside of the employer's control, such as severance due to depressed economic conditions. In certain situations, the employer may be able to verify that an employee's severance was not employer-initiated. A claim that a severance from employment was purely voluntary can be supported through items such as information from personnel files, employee statements, and other corporate records.

Employees who have had a severance from employment with the employer maintaining the plan on account of a transfer to a different controlled group are not considered as having a severance from employment for purposes of calculating the turnover rate if those employees continue to be covered by a plan that is a continuation of the plan under which they were previously covered (*i.e.,* if a portion of the plan covering those employees was spun off from the plan in accordance with the rules of § 414(l) and will continue to be maintained by the new employer).

Whether or not a partial termination of a qualified plan occurs on account of participant turnover (and the time of such event) depends on all the facts and circumstances in a particular case. Facts and circumstances indicating that the turnover rate for an applicable period is routine for the employer favor a finding that there is no partial termination for that applicable period. For this purpose, information as to the turnover rate in other periods and the extent to which terminated employees were actually replaced, whether the new employees performed the same functions, had the same job classification or title, and re-

ceived comparable compensation are relevant to determining whether the turnover is routine for the employer. Thus, there are a number of factors that are relevant to determining whether a partial termination has occurred as a result of turnover, both in the case where a partial termination is presumed to have occurred due to the turnover rate being at least 20 percent and in the case where the turnover rate is less than 20 percent.

In the present case, there is a presumption that a partial termination has occurred because the turnover rate is 20 percent or more. The facts and circumstances support the finding of a partial termination because the severances from employment occurred as a result of the shutdown of one of the employer's business locations (and not as a result of routine turnover). Therefore, a partial termination of Plan A has occurred.

If a partial termination occurs on account of turnover during an applicable period, all participating employees who had a severance from employment during the period must be fully vested in their accrued benefits, to the extent funded on that date, or in the amounts credited to their accounts.

A partial termination of a qualified plan can also occur for reasons other than turnover. For example, a partial termination can occur due to plan amendments that adversely affect the rights of employees to vest in benefits under the plan, plan amendments that exclude a group of employees who have previously been covered by the plan, or the reduction or cessation of future benefit accruals resulting in a potential reversion to the employer.

HOLDING

Under the facts described in this revenue ruling, a partial termination has occurred.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ingrid E. Grinde of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact the Employee Plans taxpayer assistance answering service between the hours of 8:30 a.m. and 4:30 p.m., Eastern time, Monday through Friday at 1–877–829–5500 (a toll-free number) or Ms. Grinde at *RetirementPlanQuestions@irs.gov*.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2007.

Rev. Rul. 2007–44

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the blended annual rate for 2007 for purposes of section 7872.

REV. RUL. 2007–44 TABLE 1

Applicable Federal Rates (AFR) for July 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.97%	4.91%	4.88%	4.86%
110% AFR	5.47%	5.40%	5.36%	5.34%
120% AFR	5.98%	5.89%	5.85%	5.82%
130% AFR	6.48%	6.38%	6.33%	6.30%
Mid-term				
AFR	4.95%	4.89%	4.86%	4.84%
110% AFR	5.45%	5.38%	5.34%	5.32%
120% AFR	5.96%	5.87%	5.83%	5.80%
130% AFR	6.46%	6.36%	6.31%	6.28%
150% AFR	7.47%	7.34%	7.27%	7.23%
175% AFR	8.74%	8.56%	8.47%	8.41%
Long-term				
AFR	5.15%	5.09%	5.06%	5.04%
110% AFR	5.68%	5.60%	5.56%	5.54%
120% AFR	6.20%	6.11%	6.06%	6.03%
130% AFR	6.73%	6.62%	6.57%	6.53%

REV. RUL. 2007–44 TABLE 2

Adjusted AFR for July 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.66%	3.63%	3.61%	3.60%
Mid-term adjusted AFR	3.81%	3.77%	3.75%	3.74%
Long-term adjusted AFR	4.32%	4.27%	4.25%	4.23%

REV. RUL. 2007–44 TABLE 3

Rates Under Section 382 for July 2007

Adjusted federal long-term rate for the current month	4.32%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.32%

REV. RUL. 2007–44 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for July 2007

Appropriate percentage for the 70% present value low-income housing credit	8.18%
Appropriate percentage for the 30% present value low-income housing credit	3.50%

REV. RUL. 2007–44 TABLE 5	
Rate Under Section 7520 for July 2007	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	6.0%

REV. RUL. 2007–44 TABLE 6	
Blended Annual Rate for 2007	
Section 7872(e)(2) blended annual rate for 2007	4.92%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 2032A.—Valuation of Certain Farm, etc., Real Property

26 CFR 20.2032A–4: Method of valuing farm real property.

Special use value; farms; interest rates. The 2007 interest rates to be used in computing the special use value of farm real property for which an election is made under section 2032A of the Code are listed for estates of decedents.

Rev. Rul. 2007–45

This revenue ruling contains a list of the average annual effective interest rates on new loans under the Farm Credit System. This revenue ruling also contains a list of the states within each Farm Credit System Bank Chartered Territory.

Under § 2032A(e)(7)(A)(ii) of the Internal Revenue Code, rates on new Farm Credit System Bank loans are used in computing the special use value of real property used as a farm for which an election is made under § 2032A. The rates in this revenue ruling may be used by estates that value farmland under § 2032A as of a date in 2007.

Average annual effective interest rates, calculated in accordance with § 2032A(e)(7)(A) and § 20.2032A–4(e) of the Estate Tax Regulations, to be used under § 2032A(e)(7)(A)(ii), are set forth in the accompanying Table of Interest Rates (Table 1). The states within each Farm Credit System Bank Chartered Territory are set forth in the accompanying Table of Farm Credit System Bank Chartered Territories (Table 2).

Rev. Rul. 81–170, 1981–1 C.B. 454, contains an illustrative computation of an average annual effective interest rate. The rates applicable for valuation in 2006 are in Rev. Rul. 2006–32, 2006–1 C.B. 1170. For rate information for years prior to 2006, see Rev. Rul. 2005–41, 2005–2 C.B. 69, and other revenue rulings that are referenced therein.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lane Damazo of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Lane Damazo at (202) 622–3090 (not a toll-free call).

REV. RUL. 2007–45 TABLE 1

TABLE OF INTEREST RATES
(Year of Valuation 2007)

Farm Credit System Bank Servicing State in Which Property is Located	Rate
AgFirst, FCB	7.17
AgriBank, FCB	6.10
CoBank, ACB	5.58
Texas, FCB	6.08
U.S. AgBank, FCB	5.81

REV. RUL. 2007–45 TABLE 2

TABLE OF FARM CREDIT SYSTEM BANK CHARTERED TERRITORIES

Farm Credit System Bank	Location of Property
AgFirst, FCB	Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia.
AgriBank, FCB	Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, Wyoming.
CoBank, ACB	Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington.
Texas, FCB	Alabama, Louisiana, Mississippi, Texas.
U.S. Agbank, FCB	Arizona, California, Colorado, Hawaii, Kansas, New Mexico, Nevada, Oklahoma, Utah.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(n)–1: Disclosure of returns and return information in connection with written contracts or agreements for the acquisition of property or services for tax administration purposes.

T.D. 9327

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Disclosure of Returns and Return Information in Connection With Written Contracts or Agreements for the Acquisition of Property or Services for Tax Administration Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations relating to the disclosure of returns and return information pursuant to section 6103(n) of the Internal Revenue Code (Code). The final regulations describe the circumstances under which officers or employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice, may disclose returns and return information to obtain property or services for tax administration purposes, pursuant to a written contract or agreement. The final regulations also set forth safeguard requirements that are designed to protect the confidentiality of returns and return information in the hands of contractors, agents, and subcontractors, and their officers and employees, and notification requirements that must be provided, in writing, to officers and employees of the contractors, agents, and subcontractors to inform them that any returns or return information they receive pursuant to these regulations may only be used for the purpose for which it is disclosed to them and that they are subject to the civil and criminal provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the returns or return information.

The final regulations will affect officers and employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice, who disclose returns or return information in connection with a written contract or agreement for the acquisition of property or services for tax administration purposes. The final regulations also will affect any person, or officer, employee, agent, or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information in connection with a written contract or agreement for the acquisition of property or services.

DATES: *Effective Date*: These regulations are applicable June 5, 2007.

Applicability Date: For dates of applicability, see §301.6103(n)–1(g).

FOR FURTHER INFORMATION CONTACT: Helene R. Newsome, 202–622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1821.

The collection of information in these final regulations is in §§301.6103(n)–1(d) and 301.6103(n)–1(e)(3). This information is required and will be used to ensure compliance with the internal revenue laws and regulations, and to protect the privacy of taxpayers.

Estimated total annual reporting burden: 250 hours. Estimated average annual burden per respondent: 6 minutes.

Estimated number of respondents: 2500.

Estimated annual frequency of responses: Annually.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224 and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 6103(a), returns and return information are confidential unless the Code authorizes disclosure. Section 6103(n) authorizes, pursuant to regulations prescribed by the Secretary, returns and return information to be disclosed to any person, including any person described in section 7513(a), for purposes of tax administration, to the extent necessary in connection with: (1) the processing, storage, transmission, and reproduction of returns and return information; (2) the programming, maintenance, repair, testing, and procurement of equipment; and (3) the providing of other services.

On January 12, 2005, a notice of proposed rulemaking (REG–148867–03, 2005–1 C.B. 646) was published in the **Federal Register** (70 FR 2076). The proposed regulations clarified that redisclosures of returns or return information by contractors to their agents or subcontractors are permissible provided that the IRS, in writing, authorizes the redisclosures. The proposed regulations also clarified that agents and subcontractors are persons described in section 6103(n) and, accordingly, are subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of returns or return information. The proposed regulations further clarified that agents and subcontractors are required to comply with any written notification requirements and safeguard restrictions that may be imposed by the IRS.

Finally, the proposed regulations clarified that section 6103(n) applies to written contracts or agreements that are entered into to obtain property or services for tax administration purposes, including contracts that are not awarded under the Federal Acquisition Regulations, 48 CFR parts 1 through 53.

One written comment responding to the notice of proposed rulemaking was received. No public hearing was requested or held. After consideration of the comment, the regulations are adopted as proposed.

Summary of Comment

The commentator recommended that the final regulations provide that any contractor and its agent or subcontractor, who has access to returns or return information under section 6103(n), be required to designate a natural person in the employ of each contractor, agent, or subcontractor who shall have: (1) cognizance and control over all disclosures by such contractor, agent, or subcontractor; (2) the authority to flow down the sanctions set forth in §301.6103(n)–1(e)(4) to lower-tiered agents or subcontractors in the event of their breach of or noncompliance with §301.6103(n)–1; and (3) the authority to apprise promptly the IRS and/or higher-tiered contractors, agents, or subcontractors of such breaches or noncompliance. The commentator explained that imposition of the above requirement would be helpful in discouraging and preventing unauthorized disclosures of returns and return information in the context of contracting and subcontracting. Because the comment was more in the nature of a contractual (case-by-case) rather than a regulatory recommendation, the final regulations do not adopt this recommendation.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that any burden on taxpayers is minimal in that the estimated average burden per respondent for complying with the collection of information imposed by these regulations is 6 minutes. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these regulations is Helene R. Newsome, Office of the Associate Chief Counsel (Procedure & Administration), Disclosure & Privacy Law Division.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINSTRATION

Paragraph 1. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6103(n)–1 is revised to read as follows:

§301.6103(n)–1 Disclosure of returns and return information in connection with written contracts or agreements for the acquisition of property or services for tax administration purposes.

(a) *General rule.* (1) Pursuant to the provisions of section 6103(n) of the Internal Revenue Code and subject to the conditions of this section, officers and employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice, are authorized to disclose returns and return information (as defined in section 6103(b)) to any person (including, in the case of the Treasury Department, any person described in section 7513(a)), or to an officer or employee of the person, for purposes of tax administration (as defined in section 6103(b)(4)), to the extent necessary in connection with a written contract or agreement for the acquisition of—

(i) Equipment or other property; or

(ii) Services relating to the processing, storage, transmission, or reproduction of returns or return information, the programming, maintenance, repair, or testing of equipment or other property, or the providing of other services.

(2) Any person, or officer or employee of the person, who receives returns or return information under paragraph (a)(1) of this section, may—

(i) Further disclose the returns or return information to another officer or employee of the person whose duties or responsibilities require the returns or return information for a purpose described in this paragraph (a); or

(ii) Further disclose the returns or return information, when authorized in writing by the Internal Revenue Service (IRS), to the extent necessary to carry out the purposes described in this paragraph (a). Disclosures may include disclosures to an agent or subcontractor of the person, or officer or employee of the agent or subcontractor.

(3) An agent or subcontractor, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a)(2)(ii) of this section, may further disclose the returns or return information to another officer or employee of the agent or subcontractor whose duties or responsibilities require the returns or return information for a purpose described in this paragraph (a).

(4) Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under this paragraph (a), may, subject to the provisions of §301.6103(p)(2)(B)–1 (concerning disclosures by a Federal, State, or local agency, or its agents or contractors), further disclose the returns or return information for a purpose authorized, and subject to all applicable conditions imposed, by section 6103.

(b) *Limitations.* (1) Disclosure of returns or return information in connection with a written contract or agreement for the acquisition of property or services described in paragraph (a) of this section will be treated as necessary only if the performance of the contract or agreement cannot otherwise be reasonably, properly, or economically carried out without the disclosure.

(2) Disclosure of returns or return information in connection with a written contract or agreement for the acquisition of property or services described in paragraph (a) of this section shall be made only to the extent necessary to reasonably, properly, or economically perform the contract. For example, disclosure of returns or return information to employees of a contractor for purposes of programming, maintaining, repairing, or testing computer equipment used by the IRS or a State tax agency shall be made only if the services cannot be reasonably, properly, or economically performed without the disclosure. If it is determined that disclosure of returns or return information is necessary, and if the services can be reasonably, properly, or economically performed by disclosure of only parts or portions of a return or if deletion of taxpayer identity information (as defined in section 6103(b)(6)) reflected on a return would not seriously impair the ability of the employees to perform the services, then only the parts or portions of the return, or only the return with taxpayer identity information deleted, may be disclosed.

(c) *Penalties.* Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, is subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the returns or return information.

(d) *Notification requirements.* Any person, or agent or subcontractor of the person, who receives returns or return information under paragraph (a) of this section shall provide written notice to his, her, or its officers and employees receiving the returns or return information that—

(1) Returns or return information disclosed to the officer or employee may be used only for a purpose and to the extent authorized by paragraph (a) of this section and that the officer or employee is subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the returns or return information;

(2) Further inspection of any returns or return information for a purpose or to an extent not authorized by paragraph (a) of this section constitutes a misdemeanor, punishable upon conviction by a fine of as much as $1,000, or imprisonment for as long as 1 year, or both, together with costs of prosecution;

(3) Further disclosure of any returns or return information for a purpose or to an extent not authorized by paragraph (a) of this section constitutes a felony, punishable upon conviction by a fine of as much as $5,000, or imprisonment for as long as 5 years, or both, together with the costs of prosecution;

(4) Further inspection or disclosure of returns or return information by any person who is not an officer or employee of the United States for a purpose or to an extent not authorized by paragraph (a) of this section may result also in an award of civil damages against that person in an amount not less than $1,000 for each act of unauthorized inspection or disclosure; or the sum of actual damages sustained by the plaintiff as a result of the unauthorized inspection or disclosure plus, in the case of a willful inspection or disclosure or an inspection or disclosure that is the result of gross negligence, punitive damages. In addition, costs and reasonable attorneys fees may be awarded; and

(5) A conviction for an offense referenced in paragraph (d)(2) or (3) of this section shall, in addition to any other punishment, result in dismissal from office or discharge from employment if the person

convicted is an officer or employee of the United States.

(e) *Safeguards.* (1) Any person, or agent or subcontractor of the person, who may receive returns or return information under paragraph (a) of this section, shall agree, before disclosure of any returns or return information to the person, agent, or subcontractor, to permit an inspection by the IRS of his, her, or its site or facilities.

(2) Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, shall comply with all applicable conditions and requirements as the IRS may prescribe from time to time (prescribed requirements) for the purposes of protecting the confidentiality of returns and return information and preventing any disclosure or inspection of returns or return information in a manner not authorized by this section.

(3) The terms of any written contract or agreement for the acquisition of property or services as described in paragraph (a) of this section shall provide, or shall be amended to provide, that any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, shall comply with the prescribed requirements. Any contract or agreement shall be made available to the IRS before execution of the contract or agreement. For purposes of this paragraph (e)(3), a written contract or agreement shall include any contract or agreement between a person and an agent or subcontractor of the person to provide the property or services described in paragraph (a) of this section.

(4) If the IRS determines that any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, has failed to, or does not, satisfy the prescribed requirements, the IRS, consistent with the regulations under section 6103(p)(7), may take any actions it deems necessary to ensure that the prescribed requirements are or will be satisfied, including—

(i) Suspension of further disclosures of returns or return information by the IRS to the State tax agency, the Social Security Administration, or the Department of Justice, until the IRS determines that the conditions and requirements have been or will be satisfied;

(ii) Suspension of further disclosures by the Treasury Department otherwise authorized by paragraph (a) of this section; and

(iii) Suspension or termination of any duty or obligation arising under a contract or agreement with the Treasury Department.

(f) *Definitions.* For purposes of this section—

(1) The term *Treasury Department* includes the IRS, the Office of the Chief Counsel for the IRS, and the Office of the Treasury Inspector General for Tax Administration;

(2) The term *State tax agency* means an agency, body, or commission described in section 6103(d); and

(3) The term *Department of Justice* includes offices of the United States Attorneys.

(g) *Effective date.* This section is applicable on June 5, 2007.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved May 19, 2007.

Eric Solomon,
Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on June 4, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 5, 2007, 72 F.R. 30974)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2007. See Rev. Rul. 2007-44, page 47.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also, Part I, §§ 401; 1.401(b)–1.)

Rev. Proc. 2007–44

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PART I — OVERVIEW

SECTION 1. PURPOSE

.01 Rev. Proc. 2005–66, 2005–2 C.B. 509, established a system of cyclical remedial amendment periods under § 401(b) of the Internal Revenue Code (Code) for individually designed and pre-approved qualified plans. This revenue procedure updates and supersedes Rev. Proc. 2005–66. Section 3 describes the changes to Rev. Proc. 2005–66 in this revenue procedure.

(1) Under this system, every individually designed plan qualified under § 401(a) has a regular, five-year remedial amendment cycle. The cycles are staggered and spread over five-year periods. That is, the cycles commence in different years for different plans within a five-year period, so that different plans have different cycles. The effect of this system is that plan sponsors need to apply for new determination letters generally only once every five years in order to continue to have a letter on which to rely.

(2) In addition, under this system, every pre-approved plan (that is, every master and prototype (M&P) and volume submitter (VS) plan), generally has a regular, six-year remedial amendment cycle. As a result, sponsors, practitioners (including mass submitters and national sponsors), as defined in Rev. Proc. 2005–16, 2005–1 C.B. 674, and generally referred to collectively in this revenue procedure as "sponsors or practitioners" unless otherwise noted, as well as adopters of pre-approved plans, generally need to apply for new opinion, advisory, or determination letters only once every six years. Pre-approved defined contribution plans have different six-year remedial amendment cycles than pre-approved defined benefit plans. Thus, the same six-year remedial amendment cycle applies with respect to all pre-approved defined contribution plans, and a separate six-year remedial amendment cycle applies with respect to all pre-approved defined benefit plans. Also, this revenue procedure provides rules for adopting employers to adopt a pre-approved plan after the review process is completed.

.02 The system for staggered five-year remedial amendment cycles and the system for six-year amendment/approval cycles are established pursuant to the Commissioner's authority under § 401(b) of the Code and its underlying regulations to extend the remedial amendment period, and pursuant to the Commissioner's authority under § 7805(b) to establish the effective date of any rule or regulation. As a result, sponsors, practitioners, and plan sponsors submit their plan only once for an opinion, advisory, or determination letter that rules on all amendments adopted and made effective within the applicable remedial amendment cycle.

.03 These remedial amendment cycles are coordinated with the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16 (EGTRRA) remedial amendment period, as defined further in section 2.07 of this revenue procedure, for both individually designed and pre-approved plans.

(1) The EGTRRA remedial amendment period for individually designed plans extends to the end of the initial applicable five-year remedial amendment cycle as provided in the chart found in section 12.01. Therefore, plan sponsors may avoid unnecessarily filing two determination letter applications by waiting to file their EGTRRA determination letter applications until the twelve-month period preceding the end of the plan's initial applicable five-year remedial amendment cycle.

(2) The EGTRRA remedial amendment period for pre-approved plans extends to the end of the initial applicable six-year remedial amendment cycle as provided in section 18.01.

SECTION 2. BACKGROUND

.01 Section 401(b) of the Code provides a remedial amendment period during which a plan may be amended retroactively to comply with the Code's qualification requirements. Section 1.401(b)–1 of the Income Tax Regulations describes the disqualifying provisions that may be amended retroactively and the remedial amendment period during which retroactive amendments may be adopted. The regulations also grant the Commissioner the discretion to designate certain plan provisions as disqualifying provisions and to extend the remedial amendment period.

.02 Section 1.401(b)–1 provides that a plan that fails to satisfy the requirements of § 401(a) solely as a result of a disqualifying provision defined under § 1.401(b)–1(b) need not be amended to comply with those requirements until the last day of the remedial amendment period with respect to the disqualifying provision, provided the amendment is made retroactively effective to the beginning of the remedial amendment period. Under § 1.401(b)–1(b)(1), a disqualifying provision includes a provision of a new plan, the absence of a provision from a new plan, or an amendment to an existing plan which causes the plan to fail to satisfy the requirements of the Code applicable to the qualification of the plan as of the date the plan or amendment is first made effective. Under § 1.401(b)–1(b)(3), a disqualifying provision includes a plan provision designated, at the Commissioner's discretion, as a disqualifying provision that either (i) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements; or (ii) is integral to a qualification requirement of the Code that has been changed. For this purpose § 1.401(b)–1(c)(1) provides that a disqualifying provision includes the absence from a plan of a provision required by or, if applicable, integral to the applicable change in the qualification requirements of the Code, if the plan was in effect on the date the change in those requirements became effective with respect to the plan. Under § 1.401(b)–1(c)(3), the Commissioner

may impose limits and provide additional rules regarding the amendments that may be made with respect to disqualifying provisions described in § 1.401(b)–1(b)(3).

.03 For a disqualifying provision of a new plan described in § 1.401(b)–1(b)(1), the remedial amendment period begins on the date the plan is put into effect and, in the case of a plan maintained by one employer, ends on the later of the due date (including extensions) for filing the employer's tax return for the taxable year in which the plan is put into effect or the last day of the plan year in which the plan is put into effect. A new plan maintained by more than one employer need not be amended until the last day of the tenth month following the last day of the plan year that includes the date the plan is put into effect.

.04 For a disqualifying provision that is an amendment to an existing plan described in § 1.401(b)–1(b)(1), the remedial amendment period begins on the earlier of the date the plan amendment is adopted or put into effect and, in the case of a plan maintained by one employer, ends on the later of the due date for filing the employer's tax return (including extensions) for the taxable year in which the amendment is adopted or effective (whichever is later) or the last day of the plan year in which the amendment is adopted or effective (whichever is later). In the case of an amendment to an existing plan maintained by more than one employer, the plan need not be amended until the last day of the tenth month following the last day of the plan year in which the amendment is adopted or effective (whichever is later).

.05 For a disqualifying provision described in § 1.401(b)–1(b)(3), the remedial amendment period begins on the date on which the change becomes effective with respect to the plan or, in the case of a provision that is integral to a qualification requirement that has been changed, the first day on which the plan is operated in accordance with the provision as amended. In the case of a plan maintained by one employer, the remedial amendment period for a disqualifying provision described in § 1.401(b)–1(b)(3) ends on the later of: (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins or (2) the last day of the plan year that includes the date on which the remedial amendment period begins. A plan maintained by more than one employer need not be amended until the last day of the tenth month following the last day of the plan year in which the remedial amendment period begins.

.06 Section 1.401(b)–1(f) provides that the Commissioner may extend the remedial amendment period at his discretion.

.07 Notice 2001–42, 2001–2 C.B. 70, provided a remedial amendment period under § 401(b), ending no earlier than the end of the 2005 plan year, in which any needed retroactive remedial plan amendments for EGTRRA must be adopted (the EGTRRA remedial amendment period). The availability of the EGTRRA remedial amendment period was conditioned on the timely adoption of required good faith EGTRRA plan amendments. In general, a good faith EGTRRA plan amendment is adopted timely if it is adopted by the later of the end of the plan year that includes the effective date of the EGTRRA change or the end of the plan's GUST remedial amendment period.[1] However, an employer's ability to rely on a favorable determination letter will not be adversely affected by the timely adoption of good faith EGTRRA plan amendments.

.08 The end of the EGTRRA remedial amendment period is also the last day on which retroactive remedial amendments may be adopted with respect to the requirements of the final regulations under § 401(a)(9) of the Code (required minimum distributions), Rev. Rul. 2001–62, 2001–2 C.B. 632 (applicable mortality table), and Rev. Rul. 2002–27, 2002–1 C.B. 925 (deemed § 125 compensation). Except with respect to the requirements of the final § 401(a)(9) regulations for defined benefit plans, the availability of the remedial amendment period with respect to these three requirements is conditioned on the adoption of plan amendments by the time specified in the applicable guidance (or, in the case of the final § 401(a)(9) regulations published on April 17, 2002 with respect to defined contribution plans, in Rev. Proc. 2002–29, 2002–1 C.B. 1176, as modified by Rev. Proc. 2003–10, 2003–1 C.B. 259).

.09 Rev. Proc. 2004–25, 2004–1 C.B. 791, extended the remedial amendment period with respect to disqualifying provisions described in § 1.401(b)–1(b)(1) that are put into effect (in the case of new plans) or adopted (in the case of existing plans) after December 31, 2001, to the end of the EGTRRA remedial amendment period. The effect of Rev. Proc. 2004–25 is to ensure that plan sponsors do not need to apply for more than one determination letter during the EGTRRA remedial amendment period simply because they have put a plan into effect or adopted voluntary plan amendments after December 31, 2001. The revenue procedure did not extend any other existing plan amendment or determination letter submission deadlines, such as the deadline for adoption of good faith plan amendments for EGTRRA or the final § 401(a)(9) regulations.

.10 In Notice 2004–84, 2004–2 C.B. 1030, the Service published the 2004 Cumulative List of Changes in Plan Qualification Requirements which contains qualification requirements for defined contribution pre-approved plans to be used for their first submission under the six-year remedial amendment cycle.

.11 In Rev. Proc. 2005–16, 2005–1 C.B. 674, the Service announced the opening of the initial six-year remedial amendment cycle for defined contribution pre-approved plans. As of February 17, 2005, the Service began to accept applications for opinion and advisory letters for defined contribution pre-approved plans which take into account the qualification requirements set forth in the 2004 Cumulative List. The revenue procedure also

[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

The GUST remedial amendment period generally ended on the later of February 28, 2002, or the end of a plan's 2001 plan year. However, for certain plans eligible for an extended GUST remedial amendment period under Rev. Proc. 2000–20, 2000–1 C.B. 553, the period generally ended on September 30, 2003.

contains the rules for issuing opinion and advisory letters for pre-approved plans.

.12 In Announcement 2005–36, 2005–1 C.B. 1095, the Service announced the submission deadline for sponsors and practitioners maintaining defined contribution mass submitter and national sponsor plans for the initial six-year remedial amendment cycle is October 31, 2005.

.13 In Rev. Proc. 2005–66, 2005–2 C.B. 509, the Service established a system of cyclical remedial amendment periods for qualified plans as described in section 1.01 above, and provided deadlines for the timely adoption of interim or discretionary amendments to plans in section 5.05.

(1) Plan sponsors or practitioners maintaining defined contribution non-mass submitter plans, as well as word-for-word identical adopters and minor modifiers, had until January 31, 2006, the end of the initial applicable remedial amendment cycle submission period (as stated in section 23 of Rev. Proc. 2005–16, 2005–1 C.B. 674), to submit their M&P and volume submitter plans for review, taking into account the requirements of EGTRRA and other items identified on the 2004 Cumulative List. Rev. Proc. 2005–66 also extended the deadline from October 31, 2005 to January 31, 2006, for sponsors and practitioners maintaining defined contribution mass submitter plans and national sponsor plans.

(2) The determination letter program for the initial remedial amendment cycle for some individually designed plans opened on February 1, 2006. On that date, the Service began to accept applications for determination letters for individually designed plans that take into account the requirements of EGTRRA and other items identified on the 2005 Cumulative List.

.14 Notice 2005–95, 2005–2 C.B. 1172, discussed the general timing rules for plan amendments and provides that the deadlines set forth under section 5.05 of Rev. Proc. 2005–66 apply, with certain exceptions. See section 5.07 of this revenue procedure and section V of Notice 2005–95 for a list of specific exceptions. In addition, Notice 2005–95 gave transitional relief to plan sponsors, practitioners and employers, providing them with an extension of the otherwise applicable deadline under section 5.05 of Rev. Proc. 2005–66 for adopting certain plan amendments reflecting the final retroactive annuity starting date regulations, the automatic rollover requirements under § 401(a)(31)(B), and the final § 401(k) and § 401(m) regulations.

.15 In Notice 2005–101, 2005–2 C.B. 1219, the Service published the 2005 Cumulative List of Changes in Plan Qualification Requirements, which contains qualification requirements for single employer individually designed defined contribution plans (including employee stock ownership plans) and defined benefit plans, to be used primarily by plan sponsors of such plans that fall in Cycle A.

.16 In Rev. Proc. 2006–6, 2006–1 C.B. 204, the Service provided that it would begin to accept applications for determination letters for some individually designed plans (depending on their cycle) that take into account the qualification requirements of the Code as amended by EGTRRA.

.17 In Rev. Proc. 2007–6, 2007–1 I.R.B. 189, the Service published the annual update containing procedures for issuing determination letters on the qualified status of plans.

.18 In Notice 2007–3, 2007–2 I.R.B. 255, the Service published the 2006 Cumulative List of Changes in Plan Qualification Requirements, which contains qualification requirements for defined benefit pre-approved plans for their first submission under the initial six-year remedial amendment cycle, qualification requirements for single employer individually designed defined benefit plans and single employer individually designed defined contribution plans (including employee stock ownership plans), to be used primarily by plan sponsors of such plans that fall in Cycle B, and qualification requirements for plan sponsors of multiple employer plans which are in Cycle B.

SECTION 3. CHANGES TO REVENUE PROCEDURE 2005–66

In addition to minor revisions and clarifying language, the following changes have been made to Rev. Proc. 2005–66:

.01 The revenue procedure contains more detail on the plan qualification requirements the Service will consider in its review of opinion, advisory or determination letter applications. It clarifies that:

(1) Except as otherwise provided on the applicable Cumulative List, the Service will not consider any guidance or statutes issued or enacted after the October 1st preceding the date the applicable Cumulative List is issued, qualification requirements that become effective in a calendar year following the calendar year in which the submission period begins with respect to the applicable Cumulative List, or statutes that are first effective in the year in which the submission period begins with respect to the applicable Cumulative List, for which there is no guidance specified on the Cumulative List. (sections 4.03 and 4.04); and

(2) Special rules apply with respect to the Service's review of plans for amendments to reflect the Pension Protection Act of 2006 (PPA '06) and the procedures to submit those amendments. Although individually designed plans and multiple employer plans submitting determination letter applications may be amended for PPA '06, the Service will not consider these PPA '06 provisions in its review of plans using the 2006 and 2007 Cumulative Lists. In contrast, pre-approved defined benefit plans must be amended for certain provisions of PPA '06, and the Service will consider these amendments in its review of opinion and advisory letter applications. (section 4.05)

(3) The limitations on the Service's review of certain plans summarized in (1) and (2) above do not apply to terminating plans. (sections 4.03 and 4.05)

.02 More detail on adoption deadlines for interim and discretionary amendments is provided, including special deadlines for governmental and tax-exempt employers. In addition, the revenue procedure clarifies that other statutory provisions or guidance may set forth earlier or later deadlines, such as the delayed amendment deadline under section 1107 of PPA '06. (sections 5.05, 5.06 and 5.07)

.03 The exceptions to the general rule for determining a plan's five-year remedial amendment cycle (cycle) are expanded and clarified to provide:

(1) A governmental plan's cycle (Cycle C), applies to a governmental plan that is also a multiemployer plan, as well as to a governmental plan that is also a multiple employer plan. (section 10.04)

(2) Another exception is added for a jointly trusteed single employer collectively bargained plan, where the joint board of trustees is treated as the plan sponsor for purposes of Form 5500. The cycle for such a plan is determined based

on the EIN used on the Form 5500. (section 10.05)

(3) The exception specifying that a plan's cycle for multiple members of a controlled group or an affiliated service group under § 414(b), (c) or (m) is determined with reference to the last digit of the EIN used to report the plan on the Form 5500 is clarified to provide that this exception does not apply to multiemployer, multiple employer, or governmental plans. (section 10.05)

(4) The rules on alternative elections and the rules on entities that may make these elections have been revised. This revenue procedure clarifies that members of a controlled group or affiliated service group (controlled group) that may make the election to choose Cycle A include a parent-subsidiary controlled group as well as a controlled group that is not a parent-subsidiary controlled group. A parent-subsidiary group may choose an alternative election which is determined by reference to the last digit of the parent's EIN. The parent generally makes the election. Members of a controlled group, including a parent-subsidiary controlled group, that may not make this election include governmental plans and jointly trusteed collectively bargained plans, as well as multiemployer and multiple employer plans. (section 10.06)

(5) A new exception is added allowing an election to be made by certain groups of tax-exempt organizations that are not controlled groups or affiliated service groups under § 414 of the Code. An election may be made by a centralized organization that the cycle is determined based on the EIN of the centralized organization, if such centralized organization handles the administration and operation of plans that have substantially the same terms and are maintained by separate tax-exempt organizations (or related taxable entities in the group maintaining plans whose terms are substantially the same). (section 10.07)

(6) Details on what to include and when to file the alternative elections under section 10.06 are provided, including a new requirement that the election be filed with each determination letter application. This revenue procedure specifies that the election applies to members maintaining qualified plans, that a new member of a controlled group or affiliated service group must make an election in order for the existing members to retain the original joint election, and that an updated list of current members and plans must be maintained. In the case of a parent-subsidiary controlled group or a group described in section 10.07 with a centralized organization, a new election does not have to be made each time a member joins or leaves the group, but an updated list must be maintained by the parent. (section 10.08)

(7) In the case of a parent that has no EIN, the highest level entity in the U.S. that has an EIN is permitted to be substituted for the parent for purposes of making the alternative elections. (section 10.09)

.04 The definitions of cycle-changing events, such as merger or acquisition, change in plan sponsorship etc., have been expanded to include a plan changing its status by becoming or ceasing to be a multiemployer plan or a multiple employer plan. Details are provided on when a change in status occurs pursuant to certain elections to be a multiemployer plan. In addition, the rules cover more scenarios to determine the applicable cycle after a cycle-changing event, describing the interaction and significance of the pre-change, post-change, open, and expired cycles. (sections 11.01 and 11.02)

.05 Additional rules relating to determination letter applications specify that individually designed plans must be restated when they are submitted for determination letters and Form 6406 may no longer be used to apply for determination letters. (sections 12.03 and 12.04)

.06 Details are provided on the types of off-cycle applications for determination letters that will be given the same priority as on-cycle applications. Applications for determination letters for terminating plans, certain new plans and applications due to urgent business need are listed. (section 14.02)

.07 Rules are rewritten to clarify that the initial remedial amendment cycle for a new plan is the applicable cycle that includes the date on which the plan's initial remedial amendment period under § 1.401(b)–1 (determined without regard to the extension in section 5.03) ends. (sections 5.03 and 14.04)

.08 More examples are added or revised to reflect what the Service will review based on the Cumulative List and to illustrate the rules regarding submissions for a new plan or existing plan whose remedial amendment cycle ends after the applicable § 401(b) remedial amendment period. (section 15)

.09 More details are provided on when an employer's plan is treated as a pre-approved plan and is eligible for a six-year remedial amendment cycle, including clarifying definitions of prior adopter, new adopter, intended adopter, and existing and interim plans. (sections 17.01 – 17.06)

.10 The submission deadline to submit applications for opinion and advisory letters for sponsors and practitioners maintaining defined benefit mass submitter plans and national sponsors is extended from October 31, 2007 to January 31, 2008. (section 18.02)

.11 Rules are clarified on when an employer is entitled to remain in the six-year remedial amendment cycle (six-year cycle) after adopting an individually designed plan and making certain types of amendments, with examples. These clarifying rules include the following:

(1) With certain exceptions described in (2) and (3) below, an employer that modifies a plan so that it is no longer considered an M&P or VS plan will nevertheless stay in the six-year cycle for the current and subsequent six-year cycles. (section 19.02)

(2) An employer that is an intended adopter or prior adopter of a pre-approved plan that instead adopts an individually designed plan, or an employer that amends an M&P or VS plan to incorporate a type of plan not allowed in the pre-approved program and makes such amendment more than one year after the date the employer initially adopted the pre-approved plan, remains in the six-year cycle for the current cycle, and then switches to the five-year remedial amendment cycle (five-year cycle). (section 19.03)

(3) If (a) the nature and extent of amendments made by the employer fall within section 24.03 of Rev. Proc. 2005–16, or (b) an employer amends an M&P or VS plan to incorporate a type of plan not allowed in the pre-approved plan program within one year after the date the employer initially adopted the pre-approved plan, the applicable cycle is immediately the five-year cycle. (section 19.04)

.12 This revenue procedure removes the rule under which an M&P sponsor's authority to amend on behalf of an adopt-

ing employer is conditioned on the plan being covered by a favorable determination letter if the employer is required to obtain a determination letter in order to have reliance. It also clarifies that a sponsor should generally continue to amend on behalf of the adopting employer even if the adopting employer makes amendments to the plan. However, the sponsor no longer has the authority to amend on behalf of the employer if the Service has exercised its authority under section 24.03 of Rev. Proc. 2005–16 or the amendment is an impermissible type not allowed in the M&P pre-approved program. (section 19.05(3))

.13 New details on what constitutes an off-cycle filing for pre-approved plans are added that clarify the provisions of Rev. Proc. 2005–16 on off-cycle filings including:

(1) When to submit applications for new pre-approved plans created after the submission period for the applicable six-year cycle, when adopting employers must adopt such plans, and the applicable Cumulative List that will be used in reviewing these plans. (section 20.01)

(2) Sponsors or practitioners who submitted applications for opinion or advisory letters prior to the submission deadline for the applicable six-year cycle, with respect to pre-approved plans that were in existence prior to such submission deadline, may not also submit off-cycle applications for such plans. (section 20.02)

.14 A provision is added stating the conditions under which sponsors, practitioners or employers who made a determination with respect to a particular plan based on a reasonable and good faith interpretation of Rev. Proc. 2005–66 prior to the issuance of this revenue procedure will be deemed to have complied with this revenue procedure. (section 21)

PART II — ALL PLANS

SECTION 4. CUMULATIVE LIST OF CHANGES IN PLAN QUALIFICATION REQUIREMENTS

.01 The Service intends to publish annually a Cumulative List of Changes in Plan Qualification Requirements (Cumulative Lists). The target date for publication of the Cumulative List is mid-November of each year. The Cumulative Lists are intended to identify, on a year-by-year basis, all changes in the qualification requirements resulting from changes in statutes, or from regulations or other guidance published in the Internal Revenue Bulletin that are required to be taken into account in the written plan document that is submitted to the Service for an opinion, advisory or determination letter, as applicable.

.02 Each annual Cumulative List identifies changes in the qualification requirements of the Code as well as items of published guidance relating to the plan qualification requirements, such as regulations and revenue rulings, that will be considered by the Service in its review of plans whose submission period (whether for an opinion or advisory letter in the case of a pre-approved plan, or for a determination letter in the case of an individually designed plan) begins on the February 1st following issuance of the Cumulative List. For example, sponsors or practitioners maintaining non-mass submitter, mass submitter and national sponsor defined contribution pre-approved plans had until January 31, 2006 to submit opinion and advisory letter applications. The Service's review of these plans is based upon the 2004 Cumulative List. Similarly, in the case of Cycle A individually designed plans submitted for determination letters between February 1, 2006 and January 31, 2007, the Service's review of these plans is on the basis of the 2005 Cumulative List.

.03 Except as provided in the applicable Cumulative List or in section 8 of this revenue procedure, the Service will not consider in its review of any opinion, advisory or determination letter application any:

(1) guidance issued after the October 1 preceding the date the applicable Cumulative List is issued (this October 1 date may be extended in the applicable Cumulative List with respect to opinion or advisory letter applications);

(2) statutes enacted after the October 1 preceding the date the applicable Cumulative List is issued;

(3) qualification requirements that become effective in a calendar year after the calendar year in which the submission period begins with respect to the applicable Cumulative List (*e.g.*, qualification requirements first effective in 2009, for applications submitted during the period beginning February 1, 2008, based on the 2007 Cumulative List); or

(4) statutes that are first effective in the year in which the submission period begins with respect to the applicable Cumulative List for which there is no guidance identified on the applicable Cumulative List.

Applications submitted which contain qualification requirements described in section 4.03(1) – (4) must identify those requirements that are in the plan, in a cover letter or in an attachment to the application. The determination letter cannot be relied upon with respect to the qualification requirements described in section 4.03(1) – (4).

.04 The Service will, however, consider in its review of any opinion, advisory or determination letter application all qualification requirements that are not described in section 4.03(1) – (4). Thus, for example, a determination letter may be relied on with respect to guidance issued on or before the October 1st preceding the issuance of the applicable Cumulative List and which is effective during the calendar year in which the submission period begins, whether or not identified on the applicable Cumulative List.

.05 Special rule for PPA Amendments

(1) Except with respect to terminating plans described under section 8 of this revenue procedure, the Service will not consider provisions of the Pension Protection Act of 2006, Pub. L. No. 109–280 (PPA '06) in its review of applications for determination letters for individually designed plans and multiple employer plans using the 2006 and 2007 Cumulative Lists. Individually designed plans and multiple employer plans can be amended, at the option of plan sponsors, to include the applicable PPA '06 provisions (other than those described in section 4.03(3) above) whether or not guidance has been issued on any particular amendment. Applications submitted with respect to individually designed plans and multiple employer plans must identify, in a cover letter or in an attachment to the application, which PPA '06 provisions the plan has been amended to include and the plan provisions that reflect those PPA '06 provisions. Determination letters issued for individually designed plans and multiple employer plans using the 2006 and 2007 Cumulative Lists may not be relied upon with respect to any plan provision identified as reflecting PPA '06, regardless of whether the plan has been amended to reflect PPA '06 pro-

visions or whether the determination letter is caveated for such dated amendments.

(2) M&P plan sponsors and VS practitioners are required to include PPA '06 law changes listed on the 2006 Cumulative List that are effective in 2006 and 2007, in plan documents submitted with their opinion and advisory letter applications for pre-approved defined benefit plans. The Service will consider PPA '06 provisions effective in 2006 and 2007 in issuing opinion and advisory letters, and such letters may be relied on with respect to such PPA '06 provisions, but only for certain PPA '06 provisions specifically listed on the 2006 Cumulative List (as noted in section IV of Notice 2007–3).

SECTION 5. ADOPTION OF INTERIM AND DISCRETIONARY PLAN AMENDMENTS AND EXTENSION OF THE REMEDIAL AMENDMENT PERIOD

.01 Designation of disqualifying provision. Unless otherwise provided in future guidance, in addition to the plan provisions designated as disqualifying provisions subject to the EGTRRA remedial amendment period as described in sections 2.07, 2.08, and 2.09 of this revenue procedure, a plan provision is designated as a disqualifying provision under § 1.401(b)–1(b)(3) if the provision either —

(1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements that is effective after December 31, 2001; or

(2) is integral to a qualification requirement of the Code that has been changed effective after December 31, 2001 but only if the provision is integral to a plan provision that is a disqualifying provision under section 5.01(1) with respect to the plan.

.02 A change in a qualification requirement includes a statutory change or a change in the requirements provided in regulations or other guidance published in the Internal Revenue Bulletin. For purposes of section 5.01, a disqualifying provision includes the absence from a plan of a provision required by or, if applicable, integral to the applicable change in the qualification requirements of the Code. An amendment with respect to a disqualifying provision described in section 5.01(1) or (2) is referred to as an interim amendment for purposes of this revenue procedure.

.03 This section 5.03 extends the remedial amendment period for the disqualifying provisions described below as follows:

(1) The remedial amendment period for any disqualifying provision described in § 1.401(b)–1(b)(1) that would otherwise apply under § 1.401(b)–1 is extended to the end of the applicable remedial amendment cycle described in section 6.01 that includes the date on which the remedial amendment period would otherwise end if the disqualifying provision was a provision of, or absence of a provision from, a new plan and the plan was intended, in good faith, to be qualified. The same extension of the remedial amendment period applies to a disqualifying provision (including a disqualifying provision described in section 5.01) in the case where the employer adopts an amendment to an existing plan (without regard to whether that amendment was required to be adopted) if the amendment was adopted timely and in good faith with the intent of maintaining the qualified status of the plan. The Service will make the final determination in all cases as to whether a new plan or an amendment was adopted with the good faith intention of being qualified or maintaining qualified status.

(2) In addition, the same extension of the remedial amendment period applies to a disqualifying provision described in section 5.01 in the case where the employer (or sponsor or practitioner, if applicable) reasonably and in good faith determines during the period when an interim amendment to reflect a qualification change would otherwise be required under section 5.05 that no amendment is required because the qualification change does not impact provisions of the written plan document. Thus, for example, if a sponsor, practitioner, or employer makes such a determination and the Service in its review of the opinion, advisory, or determination letter application finds that an amendment is required, the plan would still be eligible for the five or six-year remedial amendment cycle to correct the disqualifying provision as described in section 5.01. The Service will make the final determination in all cases as to whether the sponsor's, practitioner's or employer's determination that no interim amendment was required was reasonable and in good faith.

.04 A qualified plan must be operated in accordance with written plan documents. Thus, when there are statutory or regulatory changes with respect to plan qualification requirements that will impact provisions of the written plan document, the adoption of an interim amendment will generally be required by the deadline set forth in section 5.05. The Service intends to concurrently identify statutory and regulatory changes to facilitate compliance with this requirement.

.05 Except as otherwise provided in section 5.06 and 5.07, the deadline for the timely adoption of an amendment with respect to any plan is determined as follows:

(1) In the case of an interim amendment, an employer (or a sponsor or a practitioner, if applicable) will be considered to have timely adopted the amendment if the plan amendment is adopted by the end of the remedial amendment period described in section 2.05 (determined without regard to the extension under section 5.03 of this revenue procedure).

(2) In the case of a discretionary amendment (*i.e.*, one which is not an interim amendment described in section 5.02), an employer (or a sponsor or a practitioner, if applicable) will be considered to have timely adopted the amendment, if the plan amendment is adopted by the end of the plan year in which the plan amendment is effective.

.06 Special deadlines for governmental and tax exempt employers

(1) Governmental Plans Within the Meaning of § 414(d) of the Code. The adoption deadline for interim amendments or discretionary amendments is: the later of (a) the deadline that would apply under the regular applicable rules of section 5.05(1) and (2), or (b) the last day of the next regular legislative session beginning after the amendment's effective date in which the governing body with authority to amend the plan can consider a plan amendment under the laws and procedures applicable to the governing body's deliberations.

(2) Tax Exempt Employers. In the case of a tax exempt employer, the adoption deadline for interim amendments is set forth in section 2.05 as modified in this section 5.06(2). For purposes of determining the tax filing deadline, the following is

substituted for the language under section 2.05(1) describing the due date (including extensions) for filing the income tax return for the employer's taxable year. The due date for filing the employer's tax return in the case of a tax exempt employer that files Form 990–T (Form 990 or Form 990–EZ if no Form 990–T is filed) is the later of the 15th day of the 10th month after the end of the employer's tax year (treating the calendar year as the tax year if the employer does not have a tax year) or the due date for filing the Form 990 series (plus extensions). An employer will not be treated as having obtained an extension of time for filing the Form 990 series unless such extension is actually applied for and granted. The due date for filing the employer's tax return in the case of a tax exempt employer that is not required to file a Form 990 series return is the 15th day of the 10th month after the end of the employer's tax year (treating the calendar year as the tax year if the employer does not have a tax year).

.07 Exceptions to section 5.05 amendment adoption deadlines

(1) Section 5.05 applies except when a statutory provision or guidance issued by the Service sets forth an earlier deadline to timely adopt a discretionary amendment with respect to a plan year (*e.g.*, an amendment to add a qualified cash or deferred arrangement to a profit sharing plan cannot be adopted retroactively) or where a statutory provision or guidance provides another specific deadline for the adoption of a particular type of interim amendment that is earlier or later than the deadlines under section 5.05. For example, section V of Notice 2005–95 lists specific deadlines to amend for specific provisions.

(2) Section 1107 of PPA '06 is a statutory provision that changes otherwise applicable deadlines under section 5.05. Under section 1107 of PPA '06, a plan sponsor is permitted to delay adopting a plan amendment pursuant to statutory provisions under PPA '06 (or pursuant to any regulation issued under PPA '06) until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 in the case of governmental plans). This amendment deadline applies to both interim and discretionary amendments that are made pursuant to PPA '06 statutory provisions or any regulation issued under PPA '06. If section 1107 of PPA '06 applies to an amendment of a plan, such a plan shall not fail to meet the requirements of Code § 411(d)(6) by reason of such amendment, except as provided by the Secretary of the Treasury. Accordingly, future guidance issued by the Secretary may limit the availability of a retroactive plan amendment under PPA section 1107 in order for the plan to meet the requirements of Code § 411(d)(6). For additional special rules relating to PPA '06 amendments, see section 4 of this revenue procedure.

.08 For purposes of this revenue procedure, a pre-approved or individually designed plan restatement which is generally effective as of a certain date should not be treated as superseding a previously adopted interim plan amendment that is effective after the restatement's effective date and that has not been incorporated or reflected in the restatement provided the pre-approved or individually designed plan is operated in a manner consistent with the interim plan amendment. For this purpose, a plan is presumed to be operating in compliance with the interim plan amendments in any case (such as a determination letter application) in which the operation of the plan cannot be determined. This section 5.08 applies for all purposes, including the determination of plan qualification, funding requirements, and deductions.

SECTION 6. PLAN AMENDMENTS AND OPERATIONAL REQUIREMENTS UNDER FIVE-YEAR AND SIX-YEAR REMEDIAL AMENDMENT CYCLES

.01 The five-year remedial amendment cycles for individually designed plans are established in section 9, and the extension and schedule of the end of the five-year remedial amendment cycles are provided in section 12.01. The six-year remedial amendment cycles for pre-approved plans are established in section 16, and the extension and schedule of the end of the six-year remedial amendment cycles are provided in section 18.01. The effect of these extensions is that a sponsor, practitioner, or employer generally will not need to apply for a new opinion, advisory, or determination letter more than once during any remedial amendment cycle.

.02 An interim amendment adopted timely and in good faith to correct a disqualifying provision as described in section 5.01 can itself be a disqualifying provision as described in § 1.401(b)–1(b)(1). In this situation, a remedial amendment to correct this second disqualifying provision (that is, the interim amendment which was found to be itself a disqualifying provision) must be adopted by the end of the applicable five or six-year cycle. This remedial amendment will correct both disqualifying provisions.

.03 If as described in section 5.03, a sponsor, practitioner, or employer determined that no amendment was required, but that determination was incorrect, then the sponsor, practitioner, or employer must adopt a remedial amendment to correct the disqualifying provision by the end of the applicable five-year or six-year cycle.

.04 Operational compliance with an amended plan provision that has a retroactive effective date is required for the remedial amendment period for the amended provision to begin as of the retroactive effective date. In the situation where a sponsor, practitioner, or employer timely adopted in good faith an amendment which is not a disqualifying provision as described in § 1.401(b)–1(b)(1) and the sponsor, practitioner, or employer failed to operate the plan according to the terms of the amendment, the employer should correct the operational failure under the Voluntary Correction Program (see Rev. Proc. 2006–27, 2006–1 C.B. 945).

.05 This revenue procedure does not provide relief from the requirements of § 411(d)(6) for any plan amendments including plan amendments adopted as a result of statutory or guidance changes in the plan qualification requirements. Except to the extent permitted under § 411(d)(6) and the regulations thereunder, or under a statutory provision such as section 1107 of PPA '06, § 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment. However, an amendment that eliminates or decreases benefits that have not yet accrued does not violate § 411(d)(6), provided the amendment is

adopted and effective before the benefits accrue.

SECTION 7. EXTENSION OF EGTRRA REMEDIAL AMENDMENT PERIOD

.01 The EGTRRA remedial amendment period is extended to the end of the initial five-year and six-year remedial amendment cycles, respectively.

.02 This extension of the EGTRRA remedial amendment period extends the remedial amendment period for all disqualifying provisions to which the EGTRRA remedial amendment period applies, including plan provisions required or permitted to be amended for EGTRRA, final regulations under § 401(a)(9) of the Code, Rev. Rul. 2001–62, Rev. Rul. 2002–27, and disqualifying provisions described in Rev. Proc. 2004–25.

.03 This extension is only available to plans that satisfy the conditions for eligibility for the EGTRRA remedial amendment period as set forth in Notice 2001–42 which requires the adoption of timely good faith EGTRRA plan amendments or other plan amendments.

SECTION 8. PLAN TERMINATION

The termination of a plan ends the plan's remedial amendment period, and thus, will generally shorten the remedial amendment cycle for the plan. Accordingly, any retroactive remedial plan amendments or other required plan amendments for a terminating plan must be adopted in connection with the plan termination (that is, plan amendments required to be adopted to reflect qualification requirements that apply as of the date of termination regardless of whether such requirements are included on the most recently published Cumulative List). An application will be deemed to be filed in connection with plan termination if it is filed no later than the later of (i) one year from the effective date of the termination, or (ii) one year from the date on which the action terminating the plan is adopted. However, in no event can the application be filed later than twelve months from the date of distribution of substantially all plan assets in connection with the termination of the plan. See section 14 with respect to the Service's review of an application for a determination letter with respect to a terminating plan.

PART III — INDIVIDUALLY DESIGNED PLANS

SECTION 9. ESTABLISHMENT OF FIVE-YEAR REMEDIAL AMENDMENT CYCLES FOR INDIVIDUALLY DESIGNED PLANS

.01 This Part III sets forth rules and procedures for the five-year remedial amendment cycles for individually designed plans.

.02 In general, a plan's five-year remedial amendment cycle is determined by reference to the last digit of the employer identification number (EIN) of the employer that sponsors the plan (including a self-employed person with no employees). However, in particular circumstances, as described in section 10, a different rule is, or may be, used to determine a plan's five-year remedial amendment cycle.

.03 Under the general rule, a plan's five year remedial amendment cycle is determined as follows:

If the last digit of the plan sponsor's EIN is —	The plan's cycle is —
1 or 6	Cycle A
2 or 7	Cycle B
3 or 8	Cycle C
4 or 9	Cycle D
5 or 0	Cycle E

SECTION 10. EXCEPTIONS TO THE GENERAL RULE FOR DETERMINING A PLAN'S FIVE-YEAR REMEDIAL AMENDMENT CYCLE

.01 The following rules apply to determine the five-year remedial amendment cycle of a plan maintained by more than one employer, a plan maintained by multiple members of a controlled group under § 414(b) or (c) or employers that are members of an affiliated service group under § 414(m), a governmental plan and other special situations.

.02 For a plan that is a multiemployer plan under § 414(f), the plan's five-year remedial amendment cycle is Cycle D.

.03 For a plan that is a multiple employer plan, the plan's five-year remedial amendment cycle is Cycle B.

.04 For a plan that is a governmental plan under § 414(d), including a governmental plan that is described in section 10.02 or 10.03, the plan's five-year remedial amendment cycle is Cycle C.

.05 In the case of (1) a jointly trusteed single employer collectively bargained plan where the joint board of trustees is treated as the plan sponsor for purposes of Form 5500, or (2) a plan maintained by multiple members of a controlled group under § 414(b) or (c) or an affiliated service group under § 414(m) (other than a plan described in sections 10.02, 10.03 or 10.04), the plan's five year remedial amendment cycle is determined with reference to the last digit of the EIN that is or will be used to report the plan on Form 5500, *Annual Return/Report of Employee Benefit Plan.*

.06 In lieu of the rules described in sections 9 or 10.05 for determining a plan's five-year remedial amendment cycle, if more than one plan is maintained by members of a controlled group under § 414(b) or (c) or an affiliated service group under § 414(m), the employers may elect that the five-year remedial amendment cycle for all plans maintained by any members of the group (other than a plan described in sections 10.02, 10.03, 10.04 or 10.05(1)) will be Cycle A. The Cycle A election must be made jointly by all members of the controlled or affiliated service group, except that this election may be made on behalf of all of the members by the parent, in the case of a parent-subsidiary controlled group. Alternatively, if more than one plan is maintained by a controlled group under § 414(b) or (c) that is a parent-subsidiary controlled group, the

election may be made that the remedial amendment cycle for each plan (other than a plan described in sections 10.02, 10.03, 10.04 or 10.05(1)) is determined by reference to the last digit of the parent's EIN. This alternative parent's EIN election must be made by the parent.

.07 Notwithstanding the above, if (1) separate tax-exempt organizations which are a group of related organizations but are not a controlled group under § 414(b) or (c) or an affiliated service group under § 414(m) are maintaining separate plans, (2) the terms of those plans are substantially the same, and (3) all or substantially all of the discretionary authority concerning the plans' administration and operation is handled by a centralized organization (such as a national headquarters or a common administrative committee), then an election may be made by such centralized organization that the remedial amendment cycle for all of the plans is determined based on the EIN of the centralized organization (other than a plan described in sections 10.02, 10.03, 10.04 or 10.05(1)). If the group of related organizations also includes related taxable entities to which this section 10.07 would apply if they were tax-exempt, the plans maintained by those taxable entities whose terms are substantially the same are permitted to apply the same election that can be applied for the tax-exempt entities.

.08 The elections described in sections 10.06 and 10.07 must be made (*i.e.*, signed and dated) by the end of the earliest cycle (determined as of the date of the election) for which a determination letter application would have been required to be submitted (or by the end of Cycle A, in the case of an election to choose Cycle A under section 10.06). For example, if one member is in Cycle B and another member is in Cycle C, the election to choose Cycle A under section 10.06 must be made by the due date for Cycle A.

(1) In the case of an election under section 10.06 that does not involve a parent-subsidiary controlled group, the election must be made jointly by all members sponsoring qualified plans and must list all members of the group sponsoring qualified plans that are eligible for the election (*i.e.*, plans other than those described in 10.02, 10.03, 10.04, and 10.05(1)), including each member's EIN, and the election must list all such qualified plans that are sponsored by each member of the group. If a new member joins the controlled group, that member must make an election no later than one year from the date the new member joins the controlled group in order for other members to maintain the existing election. The members already in the group do not need to make a new election each time a new member joins, or when a member leaves the controlled group. Each time the election is filed with a determination letter application, the group must attach a copy of the original election, a copy of any additional elections executed by new members, and an updated list with current information.

(2) In the case of an election made by a parent in a parent-subsidiary controlled group, the parent must include information described in (1) and may include a designation that the election made by the parent will also apply to qualified plans eligible for the election that are maintained by subsidiaries acquired in the future, and that the election will not apply to plans of subsidiaries that, in the future, are no longer in the controlled group. If the election includes such a provision, the parent does not have to make another election each time it acquires or loses subsidiaries. However, it must maintain a list providing the information under (1) above and attach this list to the election each time the election is filed. This list must be updated to provide current information each time the election is filed with a determination letter application.

(3) In the case of an election made by a centralized organization in a group described in section 10.07, the centralized organization must include all applicable information described in (1) and may include a designation that the election made by the centralized organization will also apply to qualified plans eligible for the election that are maintained by entities added to the group in the future, and that the election will not apply to plans of entities that in the future are no longer in the group described in section 10.07. If the election includes such a provision, the centralized organization does not have to make another election each time it adds or loses members. However, it must maintain a list providing the information under (1) above and attach this list to the election each time the election is filed. The updated list must be maintained by the employer and attached to the election submitted with a determination letter application.

(4) The election must be filed with each determination letter application that is submitted in accordance with this revenue procedure for qualified plans eligible for the election that are maintained by any member of the group. Once made, the election will apply and may not be modified or revoked, except as provided in this section and in section 11.

(5) If an election under section 10.06 and 10.07 to choose a particular cycle for all plans is not timely or correctly made in accordance with this section 10.08, a plan's applicable five-year cycle may change. See section 11 below on how to determine a plan's applicable cycle after a cycle-changing event.

.09 In the case of a parent that has no EIN (such as a foreign entity) the highest level entity in the U.S. that has an EIN is permitted to be substituted for the parent for purposes of making either election in section 10.06, for maintaining the updated list described in section 10.08(2), and for determining the relevant EIN where the election is determined by reference to the parent's EIN. In such case, a cover letter or an attachment must be submitted with each determination letter application explaining how this EIN was determined.

SECTION 11. RULES FOR DETERMINING FIVE-YEAR REMEDIAL AMENDMENT CYCLE IN CASES OF MERGER OR ACQUISITION, CHANGE IN PLAN SPONSORSHIP, PLAN SPIN-OFF, OR OTHER EVENTS

.01 Except as provided in section 11.02 and 11.03, in the case of a merger or acquisition, a change in plan sponsorship, or a plan spin-off, a plan's five-year remedial amendment cycle is determined as follows regardless of whether this would shorten or extend the five-year remedial amendment cycle of the plan. The change could result in the need to file a new election pursuant to section 10.08:

(1) If plans with different five-year remedial amendment cycles are merged, the five-year remedial amendment cycle of the merged plan is thereafter determined as provided in section 9 or 10 on the basis of the EIN, controlled group status, affiliated

service group status, etc., of the employer that maintains the merged plan;

(2) If one employer acquires another employer and maintains its plan, the five-year remedial amendment cycle of the plan is thereafter determined as provided in section 9 or 10 on the basis of the EIN, controlled group status, affiliated service group status, etc., of the employer that is maintaining the plan;

(3) If there is a change in the EIN (including the expiration of the EIN), controlled group status, affiliated service group status, etc., of the employer that maintains a plan, the five-year remedial amendment cycle of the plan is thereafter determined as provided in section 9 or 10 on the basis of the changed EIN, controlled group status, affiliated service group status, etc., of the employer that maintains the plan;

(4) If a portion of a plan is spun off, the five-year remedial amendment cycle of the spun-off plan is determined as provided in section 9 or 10 on the basis of the EIN, controlled group status, affiliated service group status, etc., of the employer that maintains the spun-off plan;

(5) If a self-employed person with no employees submits a determination letter application based upon the last digit of the individual's social security number (SSN) instead of the EIN for the first determination letter submitted under this revenue procedure, the determination letter application will be processed based upon the SSN with the other on-cycle determination letter applications. However, subsequent five-year remedial amendment cycles will be determined based upon the last digit of the employer's EIN as provided in section 9 or 10 (see Publication 583, *Starting a Business and Keeping Records*);

(6) If a plan changes its status by becoming or ceasing to be a multiemployer plan or a multiple employer plan, the five-year remedial amendment cycle of the plan is thereafter determined as provided in section 9 or 10, as applicable, on the basis of the changed status of the plan. Section 1106 of PPA '06, as amended by section 6611 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, Pub. L. No. 110–28, added ERISA § 3(37)(G) and Code § 414(f)(6) allowing certain plans to make an election by August 17, 2007, to be a multiemployer plan or to revoke a previous election to not treat the plan as a multiemployer plan. Such a plan may make an election pursuant to a submission to the Pension Benefit Guaranty Corporation (PBGC). For purposes of determining the five-year remedial amendment cycle of such a plan under this revenue procedure, the change in status of the plan is deemed to occur on the date of the submission to the PBGC. However, such a plan's future five-year remedial amendment cycle will depend on the plan's status in that cycle (either as a multiemployer plan or other type of plan with a different cycle).

.02 As a result of one of the cycle-changing events described in this section, a plan's five-year remedial amendment cycle may change. In such case, a cover letter or attachment to the determination letter application with respect to the plan should note the cycle change and explain why there was a change in the plan's cycle. All relevant information directly related to the cycle-changing event should be submitted with the determination letter application. For example, if the cycle-changing event was a plan merger or spin-off, the determination letter application should include the corporate resolutions or actions that relate to the merger or spin-off. Section 11.03 provides rules on how to determine a plan's applicable cycle immediately after such an event. However, the rules under section 11.01 will apply for the plan's next following five-year remedial amendment cycle, absent any other changes that continue to make sections 11.02 and 11.03 applicable.

.03 For purposes of the rules under this section 11.03, the following definitions apply. A "post-change" cycle is the plan's applicable five-year remedial amendment cycle that would apply to the plan after the cycle-changing event under the rules in section 11.01. A "pre-change" cycle is the five-year remedial amendment cycle that applied to the plan before the cycle-changing event. An "expired" cycle is the applicable five-year cycle for which the plan's on-cycle submission period (which occurs during the last twelve months of each applicable five-year cycle) has expired as of the date of the cycle-changing event. An "open" cycle is the applicable five-year cycle during which the plan's on-cycle submission period has not expired as of the date of the cycle-changing event. An "applicable" cycle is the five-year cycle that applies to the plan after applying the rules under section 11.02 and this section 11.03.

(1) If a plan's post-change cycle is an open cycle, and the period remaining in the post-change cycle is less than twelve calendar months, the plan's post-change cycle is extended for twelve months from the last day of the open cycle submission period. The next five-year cycle will be shortened accordingly. This plan will be reviewed using the same Cumulative List that would be used for an application for an on-cycle plan submitting on the same date as this plan's submission (*i.e.*, the applicable Cumulative List is based on the date of the plan's submission).

(2) If a plan's post-change cycle is an expired cycle, the plan's applicable cycle remains the pre-change cycle.

(3) If a plan's post-change cycle ends later than the plan's pre-change cycle, and that pre-change cycle is an open cycle, the plan is permitted to treat the pre-change cycle as the applicable cycle.

(4) If a plan's post-change cycle ends later than the plan's pre-change cycle, and that pre-change cycle is an expired cycle, the plan is permitted to treat the pre-change cycle as the applicable cycle (*i.e.*, the plan sponsor does not have to resubmit a determination letter application during the post-change cycle).

(5) If neither the plan's post-change cycle nor its pre-change cycle is an open cycle, the plan's applicable cycle is the post-change cycle, regardless of whether this post-change cycle begins before or after the pre-change cycle.

SECTION 12. EXTENSION OF THE EGTRRA REMEDIAL AMENDMENT PERIOD, SCHEDULE OF NEXT FIVE-YEAR REMEDIAL AMENDMENT CYCLE AND ADDITIONAL RULES RELATING TO DETERMINATION LETTER APPLICATIONS

.01 The end of the initial remedial amendment cycle (*i.e.*, EGTRRA remedial amendment period) as extended in section 7 is illustrated in the following chart. The chart also provides the end dates of the next five-year remedial amendment cycle.

Extension of the EGTRRA Remedial Amendment Period and Schedule of Next Five-Year Remedial Amendment Cycle			
If the EIN of the employer ends in —	The plan's cycle is —	The last day of the initial cycle (*i.e.*, EGTRRA remedial amendment period) is —	The next five-year remedial amendment cycle ends on —
1 or 6	Cycle A	January 31, 2007	January 31, 2012
2 or 7	Cycle B	January 31, 2008	January 31, 2013
3 or 8	Cycle C	January 31, 2009	January 31, 2014
4 or 9	Cycle D	January 31, 2010	January 31, 2015
5 or 0	Cycle E	January 31, 2011	January 31, 2016

.02 In accordance with section 7 of this revenue procedure, the end of a plan's EGTRRA remedial amendment cycle is the time by which plan sponsors must apply for a new determination letter, in order to have a letter on which to rely for qualification changes that have first been listed in the Cumulative Lists at least twelve months before the end of the plan's EGTRRA remedial amendment period and other qualification changes not described in section 4.03, whether or not identified on the applicable Cumulative List.

.03 In general, (except with respect to amendments reflecting the provisions of PPA '06 as described in section 4.05(1)), individually designed plans must be restated when they are submitted for determination letters for the initial remedial amendment cycle (that is, EGTRRA remedial amendment period) and subsequent remedial amendment cycles. As a result, the determination letter filing may accelerate the deadline for the incorporation of interim amendments into a restated plan document from the date described in section 5.05(1) of this revenue procedure (generally the employer's income tax return filing date (including extensions)), to an earlier date. For this purpose, submission of a working copy of the plan in a restated format will suffice, provided that copies of timely executed interim and discretionary amendments are also separately submitted with the application. In addition, submitting a restated plan in proposed form is permitted, provided that the copies of timely executed interim and discretionary amendments and the prior plan document to which these amendments apply are also submitted with the application. A plan that is submitted in proposed form, and any proposed amendments, in the case of a plan submitted as a working copy, must be adopted no later than 91 days after the date of the determination letter.

.04 Effective as of July 9, 2007, Form 6406, *Short Form Application for Determination for Minor Amendment of Employee Benefit Plan*, may not be used to apply for a determination letter. An application submitted with this form will no longer be accepted by the Service.

SECTION 13. ON-CYCLE FILING FOR DETERMINATION LETTERS

.01 In general, plan sponsors of individually designed plans that wish to preserve reliance on a plan's favorable determination letter must apply for a new determination letter for each remedial amendment cycle during the last twelve months of their plan's remedial amendment cycle, that is between February 1 and January 31 of the last year of the cycle. This is referred to as "on-cycle" filing.

.02 Determination letters issued for individually designed plans will include a statement that the letter may not be relied on after the end of the plan's first five-year remedial amendment cycle that ends more than twelve months after the application was received, and will include the specific "expiration date." Thus, determination letters issued for applications filed more than twelve months prior to the end of a five-year remedial amendment cycle may not be relied on after that cycle.

.03 In appropriate circumstances, the Service may, through generally applicable published guidance, extend the expiration dates of determination letters for a particular cycle year or years.

SECTION 14. OFF-CYCLE FILING FOR DETERMINATION LETTERS

.01 If an application for a determination letter is submitted prior to or after the last twelve month period of a plan's remedial amendment cycle (that is, the twelve-month period beginning on February 1 and ending on January 31 of the last year of the cycle), the application is filed "off-cycle" and does not satisfy section 13.01. Except with respect to terminating plans described in section 8 that must adopt amendments to reflect qualification requirements that apply as of the date of termination, the off-cycle filing will be reviewed using the same Cumulative List that would be used for an application that was filed "on-cycle" on the same date as the "off-cycle" filing date. This means that the determination letter issued for the plan may not take into account any or all of the changes in qualification requirements for which the plan must be amended within the plan's current remedial amendment cycle. Further, as stated in section 13.02, the determination letter may not be relied on after the end of the plan's first five-year remedial amendment cycle that ends more than twelve months after the application is received. Consequently, the plan may need to be further amended within the cycle and another determination letter application will need to be filed within the last twelve months of the cycle if the plan sponsor wishes to preserve reliance on a determination letter. These rules also apply to off-cycle applications that are given priority review as if they were on-cycle as described below (except for terminating plans).

.02 Generally, an off-cycle application will not be reviewed until all on-cycle plans have been reviewed and processed.

However, effective as of the date of publication of this revenue procedure, the types of applications listed below under (1)–(3) will be given the same priority as on-cycle applications. The types of applications given such review priority are:

(1) A terminating plan described in section 8.

(2) A new individually designed plan whose next regular on-cycle submission period ends at least two years after the end of the off-cycle submission period during which the plan sponsor submits its application. For this purpose, a new individually designed plan is a new plan that as of the date the application is submitted with respect to the plan would be a new plan within its initial remedial amendment cycle under §1.401(b)–1(b)(1) of the regulations, as summarized in section 2.03 of this revenue procedure (determined without regard to the extension under section 5.03 of this revenue procedure).

(3) An off-cycle application submitted in accordance with published guidance issued by the Service specifying that a determination letter must be submitted in connection with a particular event.

.03 A sponsor of a plan may request that an off-cycle application be given the same priority review as an on-cycle application due to urgent business need. The Service will consider such requests based on the facts and circumstances. However, it is expected that such an application will be given the same priority as an on-cycle application only in limited cases where exceptional circumstances exist.

.04 Although a new plan may file off-cycle and will receive review priority under section 14.02 if it is described in section 14.02(2), a new plan does not have to be submitted for a determination letter off-cycle. This is because the initial remedial amendment period for a new plan is extended to the end of the applicable remedial amendment cycle in which the remedial amendment period would otherwise end. See section 5.03.

SECTION 15. EXAMPLES RELATING TO REMEDIAL AMENDMENT CYCLES AND PLAN AMENDMENTS

For the following examples, refer to the chart found above in section 12.01 and section 12.02 which is the Extension of the EGTRRA Remedial Amendment Period and Schedule of Next Five-Year Remedial Amendment Cycle. In the following examples, both the tax year of the employer and the plan year are the calendar years and, except as otherwise provided, the plan has been operated in accordance with the plan terms, including any interim and discretionary amendments.

Example 1: Employer M is a C corporation. The last digit of Employer M's EIN is 7. Employer M adopts a new plan, Plan X on January 1, 2006. The cycle for Plan X is Cycle B. Since Employer M timely adopted Plan X in good faith with the intent of sponsoring a qualified plan, the initial remedial amendment cycle for Plan X ends January 31, 2008. Any remedial amendments required for Plan X to correct a disqualifying provision as described in § 1.401(b)–1(b)(1) must be adopted by January 31, 2008, unless an application for a determination letter is submitted by that date. To the extent there have been interim or discretionary amendments made, these amendments may be included in a working copy, and such working copy must be submitted in a restated format. A copy of each signed interim or discretionary amendment must be included with the application. The determination letter issued for the plan would apply as of the first day of the 2006 plan year. The subsequent 5-year remedial amendment cycles end on January 31, 2013, January 31, 2018, etc.

Example 2: Same facts as Example 1. On July 1, 2010, Employer M starts to operate the plan in a manner which is inconsistent with the written plan document but an amendment to reflect the plan change when made retroactively effective would not violate § 411(d)(6). This change is unrelated to a change in qualification requirement or published guidance. To conform the plan document with the plan's operation, Employer M adopts an amendment by December 31, 2010 that reflects the change in operation and such amendment is adopted in good faith with the intent of maintaining the qualified status of Plan X. Employer M submits a determination letter application on or before the end of the second five-year remedial amendment cycle (that is, January 31, 2013). During the review of the determination letter application, the Service finds that the adoption of the amendment caused the plan to fail to satisfy the requirements of the Code as of the date the amendment was first made effective. Once the Service informs Employer M that the amendment is a disqualifying provision as described in § 1.401(b)–1(b)(1), Employer M would be required to adopt an amendment which corrects the disqualifying provision by 91 days after the date of the favorable determination letter. The amendment would be retroactively effective as of July 1, 2010 and Employer M must correct its operation to the extent necessary to reflect the corrective amendment.

Example 3: Same facts as Example 1. The last day of the third five-year remedial amendment cycle for Employer M is January 31, 2018. Since the first day of the third remedial amendment cycle, (February 1, 2013) Employer M has adopted interim plan amendments timely and in good faith with the intent of maintaining the qualified status of Plan X. In 2017, Employer M updates Plan X for the qualification requirements stated in the 2016 Cumulative List by restating the plan in proposed form. Employer M submits a determination letter application using the restated plan in proposed form on or before January 31, 2018. Employer M receives a favorable determination letter. Employer M must adopt the proposed restated plan by 91 days after the date of the favorable determination letter to be considered timely under § 401(b) of the Code.

Example 4: The remedial amendment cycle for Plan Y is based on the last digit of Employer N's EIN, which is a 4. Plan Y's cycle is therefore Cycle D. The initial remedial amendment cycle (that is, EGTRRA remedial amendment period) for Plan Y ends January 31, 2010, and the subsequent 5-year remedial amendment cycle ends January 31, 2015. In November 2008, guidance that would affect the qualification of Plan Y is issued effective for the plan years beginning on or after January 1, 2009. The guidance first appears on the 2009 Cumulative List. Employer N updates Plan Y for the remedial amendment cycle that ends January 31, 2010 for qualification requirements listed on the 2008 Cumulative List. Employer N submits a determination letter application on July 1, 2009. Since the guidance was issued after the October 1 preceding the date the 2008 Cumulative List was issued and was not identified and included on such list, the Service will not consider the guidance in its review until Employer N's subsequent remedial amendment cycle. To reflect this guidance, Employer N must adopt an interim amendment timely and in good faith (that is, by the tax filing date (including extensions) for 2009). The interim amendment is effective as of the first day of the 2009 plan year and will be reviewed as part of the determination letter application submitted in the subsequent five-year remedial amendment cycle.

Example 5: Same facts as Example 4, except that the guidance was issued in September 2008, effective for the plan years beginning on or after January 1, 2010. Since this guidance was effective in a calendar year following the calendar year in which the submission period began with respect to the applicable Cumulative List, as described in section 4.03 of this revenue procedure, and was not identified and included on such list, the Service will not consider the guidance in its review until Employer N's subsequent remedial amendment cycle. To reflect this guidance, Employer N must adopt an interim amendment timely and in good faith (that is, by the tax filing date (including extensions) for 2010). The interim amendment is effective as of the first day of the 2010 plan year and will be reviewed as part of the determination letter application submitted in the subsequent five-year remedial amendment cycle.

Example 6: The remedial amendment cycle for Plan Z is based on the last digit of Employer L's EIN, which is 0. Plan Z's cycle is Cycle E. The initial five-year remedial amendment cycle (that is, EGTRRA remedial amendment period) for Plan Z ends January 31, 2011, and the subsequent 5-year remedial amendment cycle ends January 31, 2016. Employer L submits a determination letter application on March 1, 2009. The 2008 Cumulative List will be used to review Employer L's determination letter submission. Since the initial five-year remedial amendment cycle will expire on January 31, 2011, Employer L must submit a new determination letter application during the last twelve months of the remedial amendment cycle (between February 1, 2010

to January 31, 2011) to continue to have reliance on a determination letter after that date.

Example 7: Employer Q establishes Plan K on December 18, 2006. Plan K's cycle is Cycle A. The § 401(b) remedial amendment period with respect to Plan K (determined without regard to section 5.03 of this revenue procedure) ends on September 15, 2007, since Employer Q has received an extension to file its tax return for 2006. Accordingly, under section 5.03, the remedial amendment period is extended to the end of Employer Q's next remedial amendment cycle, *i.e.*, Cycle A (January 31, 2012). Employer Q submits an application for a determination letter for Plan K on September 4, 2007. Employer Q's application is given the same priority as an on-cycle filing pursuant to section 14.02(2) for purposes of determining the priority of the Service's review, and the application will be reviewed based on the 2006 Cumulative List.

Example 8: Same as Example 7, except Employer Q submits an application for a determination letter by January 31, 2007. The 2005 Cumulative List will be used to review Employer Q's submission and Plan K must contain all of the provisions that any other Cycle A plan would be required to have.

Example 9: Same as Example 7, except that Employer Q decides to wait until the applicable submission period for Cycle A plans, February 1, 2011 through January 31, 2012, to submit an application for a determination letter. The remedial amendment period will extend to the end of that remedial amendment cycle, with respect to the adoption of Plan K and all interim amendments that Employer Q has timely adopted for all applicable periods. The Service will review Employer Q's application based on the 2010 Cumulative List.

Example 10: Employer R establishes Plan L on December 18, 2006. Plan L's cycle is Cycle D. The § 401(b) remedial amendment period with respect to Plan L (determined without regard to section 5.03 of this revenue procedure) ends on September 15, 2007, since Employer R has received an extension to file its tax return for 2006. The initial five-year remedial amendment cycle for Plan L ends on January 31, 2010. Employer R submits an application for a determination letter for Plan L on September 4, 2007. Employer R's application is given the same priority as an on-cycle filing pursuant to section 14.02(2) and the application will be reviewed based on the 2006 Cumulative List. The result would be the same for purposes of the priority of the Service's review if Plan L's cycle was Cycle E, with the same facts, (except that the initial remedial amendment cycle for Plan L as a Cycle E plan would end on January 31, 2011). However, if Plan L's cycle was Cycle C, the plan would not be given the same priority as an on-cycle filing.

Example 11: Employer S adopts Plan M on December 18, 2005, effective January 1, 2005. Plan M's cycle is Cycle A. Employer S adopts an interim amendment in 2006. Employer S submits the initial application for a determination letter for Plan M on July 1, 2011. The § 401(b) remedial amendment period with respect to the interim amendment adopted for Plan M in 2006 (determined without regard to section 5.03 of this revenue procedure) ends on September 15, 2007, since Employer S has received an extension to file its tax return for 2006. Accordingly, under section 5.03, the remedial amendment period with respect to the interim amendment adopted in 2006 is extended to the end of the next remedial amendment cycle (January 31, 2012). Similarly, there is an extension of the remedial amendment period with respect to amendments timely adopted in subsequent years to the end of the remedial amendment cycle. However, this extension does not apply to the adoption of the plan in 2005 and any amendments made in 2005, since the § 401(b) remedial amendment period for 2005 (September 15, 2006 with extensions) was already extended to January 31, 2007 and expired at that time (the end of the Cycle A remedial amendment cycle). Because Employer S did not submit a determination letter application during the February 1, 2006 through January 31, 2007 Cycle A submission period, Plan M's initial remedial amendment period (taking into account the extension under section 5.03) ended January 31, 2007. Therefore, Employer S would not be permitted under § 401(b) to adopt any remedial amendments that might be necessary retroactively to 2005.

Example 12: Employer T adopted Plan N in August 2004, effective January 1, 2004. Employer T submits Plan N for a determination letter application in September 2006. The proposed Plan N restatement includes required § 401(k) amendments, effective January 1, 2006. The initial remedial amendment cycle for Plan N is Cycle A, ending on January 31, 2007. Employer T received an extension to file its income tax return for 2006 to September 15, 2007. The Service issued the determination letter in February 2007. Employer T must adopt restated Plan N, including the § 401(k) amendments, no later than 91 days after the date of the issuance of the determination letter, which is earlier than September 15, 2007. If Employer T had submitted a working copy with proposed amendments, these proposed amendments would also need to be adopted no later than 91 days after the date of the issuance of the determination letter.

PART IV — PRE-APPROVED PLANS

SECTION 16. ESTABLISHMENT OF SIX-YEAR AMENDMENT/APPROVAL CYCLE FOR PRE-APPROVED PLANS

.01 This Part IV sets forth rules and procedures for the six-year remedial amendment/approval cycles for pre-approved plans.

.02 Sponsors and practitioners maintaining non-mass submitter plans generally have until January 31st of the calendar year following the opening of the six-year remedial amendment cycle to submit applications for opinion and advisory letters. In addition, the deadline for word-for-word identical adopters and minor modifier placeholder applications is January 31st of the calendar year following the opening of the six-year remedial amendment cycle (see section 12 of Rev. Proc. 2005–16 for more details). Sponsors and practitioners maintaining mass submitter plans and national sponsors generally have until October 31st of the calendar year in which the six-year remedial amendment cycle opens to submit opinion and advisory letter applications.[2] In addition, sponsors and practitioners maintaining mass submitter plans are encouraged to submit their word-for-word and minor modifier placeholder applications by the earlier mass submitter submission deadline, October 31st. The Service will evaluate this new provision (that is, a different deadline for applications of mass submitter plans versus word-for-word and minor modifier placeholder applications) and may, at its discretion and through applicable published guidance, change the deadline date for the word-for-word and minor modifier placeholder applications in future six-year remedial amendment cycles.

.03 When the review of a cycle for pre-approved plans has neared completion (after approximately a two-year review process), the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans. This will be a uniform date that will apply to all adopting employers. Depending upon the length of the review process, it is expected that this date will give virtually all employers approximately a two-year window to adopt their updated plans. For purposes of this revenue procedure, an adopting employer means an employer who satisfies the requirements described under section 17 of this revenue procedure.

.04 An adopting employer that adopts the approved M&P or VS plan by the announced deadline will have adopted the plan within the employer's six-year remedial amendment cycle. The announced deadline will be the end of the plan's remedial amendment cycle with respect to all disqualifying provisions for which the remedial amendment period would otherwise end during the cycle.

[2] With respect to the initial EGTRRA application, section 18.02 provides a later deadline of January 31, 2006 for defined contribution M&P and VS plans and January 31, 2008 for defined benefit M&P and VS plans to be submitted by national sponsors and sponsors and practitioners maintaining mass submitter plans.

.05 If necessary, the Service may revise the schedule described in this section to respond to changing circumstances and needs of plan sponsors.

SECTION 17. ELIGIBILITY FOR SIX-YEAR AMENDMENT/APPROVAL CYCLE

.01 An employer's plan is treated as a pre-approved plan and is therefore eligible for a six-year amendment/approval cycle if:

(1) The employer is either a prior adopter described in section 17.02, a new adopter described in section 17.03, an intended adopter described in section 17.04, or the adopter of a replacement plan that meets the conditions described in section 17.05, and

(2) The sponsor or practitioner maintaining an existing or interim pre-approved plan (defined in (3) below) timely submits an opinion or advisory letter application for the plan:

(a) by the application deadline of October 31st or January 31st, whichever is applicable, in the first year of the six-year remedial amendment cycle for pre-approved plans, as described in section 18 of this revenue procedure, and

(b) receives a favorable current opinion or advisory letter from the Service before the employer adopts the plan as described in sections 17.02 through 17.05 below):

(3) For purposes of this section 17:

(a) An existing pre-approved plan is a plan that has received a valid opinion or advisory letter for the six-year cycle immediately preceding the opening of the current six-year cycle (or, in the case of the initial six-year remedial amendment cycle, February 16, 2005 for defined contribution pre-approved plans or January 31, 2007 for defined benefit pre-approved plans). An existing pre-approved plan contains separate interim and discretionary amendments attached to the plan that have not been integrated into the plan document in restated form (but that will be integrated before the plan is submitted for an opinion or advisory letter under section 17.01(2) above).

(b) An interim pre-approved plan is either:

(i) a plan that has not previously applied for or received an opinion or advisory letter because it was not in existence before the deadline for submitting such plans in the immediately preceding period (*e.g.*, GUST deadline), or

(ii) a plan that has received a valid opinion or advisory letter for the six-year cycle immediately preceding the opening of the current six-year cycle (or, in the case of the initial six-year remedial amendment cycle, February 16, 2005 for defined contribution pre-approved plans or January 31, 2007 for defined benefit pre-approved plans). An interim pre-approved plan does not contain the interim and discretionary amendments in separate documents because they have been integrated into the plan document in a restated format for purposes of submitting the plan for an opinion or advisory letter on or before the applicable date under section 17.01(2) above.

(c) A newly approved version of a plan is a plan described in section 17.01(2)(b).[3]

.02 An employer is a prior adopter if:

(1) the employer adopted and made effective a pre-approved plan as of the last day of the six-year remedial amendment cycle immediately preceding the opening of the current six-year cycle and that employer's pre-approved plan was an existing plan, or an interim pre-approved plan (under section 17.01(3)(b)(ii)) that has a valid opinion or advisory letter for the period preceding the opening of the current six-year cycle, and

(2) the employer, within the announced adoption period described in sections 16.03 and 16.04,

(a) adopts the newly approved version of that pre-approved plan or

(b) adopts the newly approved version of a different pre-approved plan maintained by either the same sponsor or a different sponsor.

.03 An employer is a new adopter if:

(1) the employer maintains an individually designed plan, or

(2) the employer is not currently maintaining any qualified plan (individually designed or pre-approved) and has not maintained any such plan during the current five-year remedial amendment cycle applicable to the employer, and

(3) the employer adopts either an existing pre-approved plan or an interim pre-approved plan before the end of the employer's five-year remedial amendment cycle as determined under Part III of this revenue procedure,

An employer may only adopt an interim or an existing pre-approved plan that is not the newly approved version of the plan if the employer adopts such plan before the beginning of the adoption period described in section 16.03 and 16.04 during the applicable six-year cycle. Such an employer must re-adopt either the newly approved version of the same plan or a newly approved version of a different pre-approved plan during the adoption period. Any employer whose five-year cycle has not ended may adopt a plan during or after the adoption period, but such employer must adopt the newly approved version of a pre-approved plan.

.04 An employer is an intended adopter if:

(1) the employer currently maintains a qualified individually designed plan and

(2) such employer and a sponsor or practitioner who maintains an existing pre-approved plan or an interim pre-approved plan execute Form 8905, *Certification of Intent To Adopt a Pre-approved Plan*[4], before the end of the employer's five-year remedial amendment cycle as determined under Part III of this revenue procedure.[5] However, if the employer's five-year remedial amendment cycle ends during or after the announced adoption period described in section 16.03 and 16.04 associated with the applicable six-year cycle, rather than execute Form 8905, the employer should instead adopt the newly approved version of a pre-approved plan (and will be treated as a new adopter under section 17.03).

.05 Replacement Plan

(1) An employer is an adopter of a replacement plan (defined in section 17.05(1)) under the following situations:

(a) The employer timely adopted a pre-approved plan that is to be replaced by a

[3] See section 20 of this revenue procedure for special rules applicable to an opinion or advisory letter application for a new pre-approved plan created after the submission period for the applicable six-year cycle.

[4] Form 8905, *Certification of Intent To Adopt a Pre-approved Plan*, is available at *www.irs.gov/ep*.

[5] An employer who executes Form 8905 may adopt a different pre-approved plan with either the same or a different sponsor instead of the one designated on Form 8905.

"replacement" plan (that is, the plan document remaining after one of the situations described in section 17.05(1)(c)); and

(b) A sponsor or practitioner maintaining the pre-approved plan does not request an opinion or advisory letter during the current six-year approval/amendment cycle because the plan is to be replaced by the plan of another sponsor or practitioner as a result of a change in business circumstances described in section 17.05(1)(c); and

(c) The sponsor or practitioner of the replacement plan and the sponsor or practitioner of the replaced plan are related in one of the following ways: (a) one was merged into the other before the last day of the submission period as described in section 17.01(2) or (b) as of the last day of the submission period as described in section 17.01(2) both are members of the same controlled group of corporations within the meaning of § 414(b) or are trades or businesses which are under common control within the meaning of § 414(c).

(2) Effect of Adoption of Replacement Plan

(a) If the employer intends to adopt the replacement plan, the employer will not be required to execute Form 8905, *Certification of Intent To Adopt a Pre-approved Plan*.

(b) If the employer applies for a determination letter for a replacement plan, the application must include a statement from the sponsor or practitioner maintaining the replacement plan indicating that the sponsor or practitioner maintaining the replaced plan was bought out or merged with the sponsor or practitioner maintaining the replacement plan.

.06 If an employer described in section 17.02, 17.03, 17.04 or 17.05 adopts a pre-approved plan or individually designed plan after the adoption and/or submission deadline established by the Service for the current six-year remedial amendment cycle and the employer is unable to utilize its five-year remedial amendment cycle, (*e.g.*, the employer's submission deadline under the five-year remedial amendment cycle precedes the adoption and/or submission deadline under the current six-year cycle), then the adopting employer may be eligible to correct for late adoption under the Voluntary Correction Program.

Examples 13 through 17 below illustrate an employer's eligibility for the six-year cycle. In the following examples, both the tax year of the employer and the plan year are the calendar years and, except as otherwise provided, the plan has been operated in accordance with the plan terms, including any interim and discretionary amendments.

Example 13: Employer L adopted and made effective Plan X on January 1, 2005. Plan X is a preexisting defined contribution pre-approved prototype plan sponsored by Sponsor M. Sponsor N of Plan Y, also a defined contribution prototype plan, timely submitted an application by January 31, 2006. In 2008 the Service announced that February 1, 2008 through January 31, 2010 would be the two-year window for employers to adopt restated pre-approved plans and file determination letters, if necessary.

Sponsor M notified Employer L that it no longer qualified as a sponsor because it did not have the requisite number of employers (30) reasonably expected to adopt the pre-approved plan. Therefore, Sponsor M did not submit a new opinion letter application within the six-year cycle by January 31, 2006. Employer L timely adopts Plan Y of Sponsor N within the two-year window period. Employer L will be considered to be a "prior adopter" within the meaning of section 17.02 of this revenue procedure and has timely adopted the plan within the six-year cycle. The result would be the same if Employer L switched to Plan Y because Sponsor M did not timely submit an application by January 31, 2006 for that prototype plan, or Sponsor M timely submitted an application by January 31, 2006 but later withdrew the application, or Employer L was dissatisfied with Sponsor M for other reasons.

Example 14: The facts are the same as Example 13 except Employer L adopts a different defined contribution pre-approved prototype plan, Plan Z, sponsored by Sponsor M within the announced two-year window period and Sponsor M timely submitted an application for an opinion letter by January 31, 2006 for Plan Z. Employer L is considered to be a prior adopter and gets the six-year remedial amendment cycle.

Example 15: Same as Example 13 except Employer L adopts a defined contribution VS plan, Plan V, instead of a prototype plan within the announced two-year window period and the Sponsor timely submitted an application for an advisory letter for Plan V by January 31, 2006. Employer L is considered to be a prior adopter and gets the six-year remedial amendment cycle.

Example 16: Employer P, whose EIN ends in 6, has never maintained a qualified plan. Sponsor S timely submitted an application for an opinion letter for Plan Y, an existing pre-approved defined contribution prototype plan, by January 31, 2006. Employer P adopts Plan Y on December 15, 2006, which is prior to the end of Employer P's five-year remedial amendment cycle (Cycle A). Employer P is a new adopter and gets the six-year remedial amendment cycle.

Example 17: Employer Q, whose EIN ends in 1, currently maintains an individually designed defined benefit plan (IDP). Employer Q decides to switch from an IDP to a defined benefit pre-approved plan. On January 15, 2007, Employer Q and Sponsor S execute Form 8905, *Certification of Intent To Adopt a Pre-approved Plan*. The defined benefit pre-approved plan adopted by Employer Q was timely submitted for an opinion letter by the applicable deadline. Employer Q is an intended adopter because Employer Q and Sponsor S signed Form 8905 timely (*i.e.*, before the end of Employer Q's five-year remedial amendment cycle).

SECTION 18. EXTENSION OF THE EGTRRA REMEDIAL AMENDMENT PERIOD AND SCHEDULE OF NEXT SIX-YEAR REMEDIAL AMENDMENT CYCLE

.01 The end of the initial remedial amendment cycle (that is, EGTRRA remedial amendment period) as extended in section 6 is illustrated in the following chart. The chart also provides the end dates (unless otherwise provided by the Service) of the next six-year remedial amendment cycle.

Extension of the EGTRRA Remedial Amendment Period and Schedule of Next Six-Year Remedial Amendment Cycle		
If the plan is —	The last day of the initial cycle (*i.e.*, EGTRRA remedial amendment period) is —	The next six-year remedial amendment cycle ends on —
Defined Contribution	January 31, 2011	January 31, 2017
Defined Benefit	January 31, 2013	January 31, 2019

.02 In general, sponsors of M&P plans and practitioners maintaining VS plans must apply for new opinion or advisory letters for the plans every six years, according to the following schedule:

(1) Defined Contribution Plans

Initial EGTRRA application due —	*Next application due —*
Non-Mass Submitter Sponsors and Practitioners, Word-for-Word Identical Adopters, and M&P Minor Modifier Placeholder Applications:	
February 17, 2005 through January 31, 2006	February 1, 2011 through January 31, 2012
Mass Submitters and National Sponsors:	
February 17, 2005 through January 31, 2006	February 1, 2011 through October 31, 2011

(2) Defined Benefit Plans

Initial EGTRRA application due —	*Next application due —*
Non-Mass Submitter Sponsors and Practitioners, Word-for-Word Identical Adopters and M&P Minor Modifier Placeholder Applications	
February 1, 2007 through January 31, 2008	February 1, 2013 through January 31, 2014
Mass Submitters and National Sponsors:	
February 1, 2007 through January 31, 2008	February 1, 2013 through October 31, 2013

.03 In accordance with section 7 of this revenue procedure, the end of a plan's EGTRRA remedial amendment cycle is the time by which an employer adopts the approved plan by the end of the deadline as announced by the Service. An adopting employer that timely adopts the approved plan will be treated as having adopted the plan within the employer's six-year remedial amendment cycle.

SECTION 19. EFFECT OF EMPLOYER AMENDMENTS OR ADOPTION OF INDIVIDUALLY DESIGNED PLAN ON SIX-YEAR REMEDIAL AMENDMENT CYCLE

.01 General Rule

An employer that amends any provision of an approved M&P plan including its adoption agreement (other than to change the choice of options, if the plan permits or contemplates such a change) is considered to have adopted an individually designed plan. (See section 5.02 of Rev. Proc. 2005–16.) An employer amending provisions of a VS plan is also considered to have adopted an individually designed plan, although such an employer has traditionally had more discretion to make amendments that differ from the specimen document and stay in the VS program. (See section 8 and section 9 of Rev. Proc. 2007–6, 2007–1 I.R.B. 189.)

.02 Eligibility for Six-Year Cycle on Continuing Basis

Except as otherwise provided in section 19.03 and 19.04, an employer who modifies a plan in such a way that the plan, as adopted by the employer, would not be considered an M&P plan or a VS plan, will nevertheless be allowed to remain within the six-year remedial amendment cycle due to the nature of the modifications, as described in section 24.02 of Rev. Proc. 2005–16. Thus, plan amendments (other than those described in sections 19.03 and 19.04 below) that are adopted timely and in good faith with the intent of maintaining the qualified status of the plan by employers sponsoring M&P and VS plans will be disregarded for purposes of determining an employer's remedial amendment cycle. In this case, the employer will remain eligible for the six-year remedial amendment cycle. Thus, the plan will continue to be treated as an M&P or VS plan for purposes of this revenue procedure and therefore eligible for the six-year remedial amendment cycle on a continuing basis as provided in section 24.02 of Rev. Proc. 2005–16.

.03 Temporary Eligibility for Six-Year Cycle

An employer who adopts an individually designed plan under (1) or (2) below or makes certain amendments to its M&P or VS plan as described under (3) and (4) below is entitled to remain in the six-year remedial amendment cycle only for the current remedial amendment cycle. This temporary eligibility for the six-year cycle applies if:

(1) the employer is an intended adopter (as described in section 17.04) and after timely executing the Form 8905, the employer decides to adopt an individually designed plan whose underlying plan document is not based on a pre-approved plan, or

(2) the employer is a prior adopter of a pre-approved plan (as described in section 17.02) and after adopting this pre-approved plan the employer replaces that plan with an individually designed plan whose underlying plan document is not based upon a pre-approved plan document, or

(3) the employer amends an approved M&P plan, including its adoption agreement, to incorporate a type of plan not allowed in the M&P program (and that amendment is adopted more than one year after the date the employer initially adopted the M&P plan (see section 6.03 of Rev. Proc. 2005–16)), or

(4) the employer amends an approved VS plan to incorporate a type of plan not allowed in the VS program (and that amendment is adopted more than one year after the date the employer initially adopted the VS plan (see section 16.02 of Rev. Proc. 2005–16));

In order to obtain reliance, such employer must submit a determination letter application during the approximate two-year period within the six-year remedial amendment cycle that the Service announces for employers to adopt plans and submit them for determination letters. The employer's plan will be reviewed using the applicable Cumulative List based on the date of the application. The subsequent remedial amendment cycle is the first five-year cycle, as determined under section 9 or 10 of this revenue procedure that ends after the closing of the six-year cycle in which the determination letter application was submitted. However, if the end of the first five-year cycle that ends after the closing of the six-year cycle is less than twelve calendar months after the date of the favorable determination letter, then the plan's current cycle is extended for twelve calendar months and the next five-year cycle will be shortened accordingly.

.04 Ineligibility for Six-Year Cycle

Notwithstanding the above, if an employer amends an approved M&P plan including its adoption agreement or an approved VS plan to such an extent that the Service determines in its discretion that the plan falls under section 24.03 of Rev. Proc. 2005–16, then the plan will be considered individually designed for purposes of this revenue procedure (that is, the employer will be subject to the applicable five-year remedial amendment cycle based on the last digit of their EIN). The same rule applies if the employer adopts an amendment described under section 19.03(3) and (4) above within one year of adopting either the M&P plan or the VS plan.

.05 Determination letter procedures

With respect to an M&P or VS plan, an employer that adopts an amendment which causes such a plan to be treated as an individually designed plan under section 19.02 and .03 of this revenue procedure, but for remedial amendment cycle purposes remains eligible for the six-year remedial amendment cycle either on a continuing or temporary basis, must file a determination letter application for reliance. The determination letter application must be filed during the approximate two-year period within the six-year remedial amendment cycle that the Service announces for employers to adopt and submit determination letter applications, (if applicable). Depending on whether a Form 5307 or 5300 is filed, the Service will use the Cumulative List used to review the underlying document, or the Cumulative List based on the date of the determination letter submission in its review. (See examples 18 through 22).

(1) Determination letter filing procedures for VS plans are set forth in section 9 of Rev. Proc. 2007–6.

(2) With respect to M&P plans, except as otherwise provided in section 9 of Rev. Proc. 2007–6 describing when a Form 5307 must be used, an employer that adopts amendments and submits a request for a determination letter must file a Form 5300. Procedures for filing the Form 5300 are similar to the procedures set forth in section 9.09 in Rev. Proc. 2007–6, for VS plans, except for the following:

(a) A list of modifications is not required to be included.

(b) Any changes adopted by the employer must be made in the form of an amendment and not incorporated into the underlying M&P plan document.

(3) While it is expected that an M&P sponsor will generally continue to amend on behalf of the adopting employer even if the adopting employer adopts amendments to the plan, the sponsor no longer has the authority to amend on behalf of the employer if the amendment falls into one of the categories listed in section 6.03 of Rev. Proc. 2005–16 or the Service has exercised its authority under section 24.03 of Rev. Proc. 2005–16.

.06 Examples

Examples 18 through 22 below illustrate how different types of employer amendments to a pre-approved plan affect an employer's eligibility for the six-year remedial amendment cycle and which Cumulative List the Service will use to review an employer's submission. In the following examples, both the tax year of the employer and the plan year are the calendar years and, except as otherwise provided, the plan has been operated in accordance with the plan terms, including any interim and discretionary amendments.

Example 18: Practitioner S maintains a defined contribution VS specimen plan. Practitioner S timely submits an advisory letter application for the initial six-year remedial amendment cycle (that is, EGTRRA remedial amendment period) on or before January 31, 2006. Practitioner S receives an advisory letter dated January 31, 2008. The Service announces that February 1, 2008 until January 31, 2010 is the time period when employers must adopt a restated pre-approved plan and, if necessary, file a determination letter application. Employer T adopts the VS specimen plan, now Plan K, on or before January 31, 2010. Employer T amends Plan K so that it is no longer word-for-word identical to the VS specimen plan. Employer T submits a determination letter application using Form 5307, *Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans*, on January 15, 2010. The Service will review the determination letter application based upon the Cumulative List used to review the underlying plan document, the 2004 Cumulative List.

The 2004 Cumulative List is used in this instance because the Service in its review determined that the amendments to the VS specimen plan did not rise to the level that necessitated the treatment of Plan K as an individually designed plan which would require Employer T to file Form 5300, *Application for Determination for Employee Benefit Plan*. Accordingly, Employer T's subsequent remedial amendment cycle will continue to be determined under Part IV of this revenue procedure. Practitioner S would submit an application for an advisory letter within the next six-year remedial amendment cycle, which ends on January 31, 2017, on or before the submission deadline for such cycle of January 31, 2012. Employer T would adopt the restated pre-approved plan and, if necessary, file a determination letter application within the time period announced by the Service.

Example 19: Employer X has maintained Plan M, a defined contribution pre-approved plan, since 2002. The last digit of Employer X's EIN is 8. Plan M is timely submitted for the initial six-year remedial amendment cycle (that is, the EGTRRA remedial amendment period) by the sponsor/practitioner on or before January 31, 2006. Generally, Employer X will have until January 31, 2011 (unless otherwise provided by the Service) to adopt the EGTRRA approved

version of the pre-approved plan and have such adoption be considered timely under § 401(b) of the Code.

In 2007, Employer X decides Plan M no longer offers the flexibility it desires in providing the retirement benefits to its employees. As a result, Employer X amends and restates Plan M in 2007 into a defined contribution individually designed plan (with the intent of maintaining the qualified status of Plan M). Though Employer X is now sponsoring an individually designed plan, Employer X, a prior adopter as described in section 17.02, is still eligible for the six-year remedial amendment cycle under section 19.03.

The Service announces that February 1, 2008 until January 31, 2010 is the time period when employers must adopt a restated pre-approved plan and, if necessary, file a determination letter application. On June 1, 2009, Employer X submits a determination letter application using Form 5300, *Application for Determination for Employee Benefit Plan*, and pays the higher user fee. The Service will review the determination letter application based upon the 2008 Cumulative List (that is, the annual Cumulative List based on the date of the determination letter submission). The subsequent remedial amendment cycle is the first five-year cycle as determined under section 9 or 10 of this revenue procedure that ends after the closing of the six-year cycle in which the determination letter application was submitted; thus, the next five-year remedial amendment cycle ends January 31, 2014.

Example 20: Employer Y, whose EIN ends with an 8, maintains Plan N. Plan N is an adoption of an M&P defined benefit plan as of 2002. The M&P plan is timely submitted for the initial six-year remedial amendment cycle (that is, EGTRRA remedial amendment period) by the sponsor on or before January 31, 2008 and the sponsor receives an opinion letter dated January 31, 2010 for the M&P plan. The Service announces February 1, 2010 until January 31, 2012, as the time period for employers to adopt a restated pre-approved plan and, if necessary, file a determination letter application.

On November 19, 2011, Employer Y adopts the restated EGTRRA approved version of an M&P plan which includes an amendment to Plan N that creates a plan described under § 414(k). Although Employer Y adopts this amendment timely and in good faith with the intent of maintaining the qualified status of Plan N, this amendment changes the provisions of the M&P plan to create a type of plan that is not allowed in the M&P program. Since Employer Y has amended the M&P plan to incorporate a type of plan for which the Service will not issue an opinion letter, Plan N is an individually designed plan. Though Employer Y is now sponsoring an individually designed plan, Employer Y is still eligible for the six-year remedial amendment cycle under section 19.03 because Employer Y is a prior adopter as described in section 17.02 and the amendment was adopted more than one year after the date Employer Y adopted Plan N in 2002.

Employer Y submits a determination letter application using Form 5300, *Application for Determination for Employee Benefit Plan*, and pays the higher user fee on December 31, 2011. The Service will review the determination letter application based upon the 2010 Cumulative List (that is, the annual Cumulative List based on the date of the determination letter submission). Employer Y receives a favorable determination letter dated March 31, 2013. Employer Y's subsequent remedial amendment cycle is the first five-year cycle, as determined under section 9 or 10 of this revenue procedure that ends after the closing of the six-year cycle in which the determination letter application was submitted; thus, the next five-year remedial amendment cycle ends January 31, 2014. However, since the end of the first five-year cycle that ends after the closing of the six-year cycle is less than twelve calendar months after the date of the favorable determination letter, the current five-year cycle is extended by twelve calendar months as provided in section 19.03. Thus the end of the five-year cycle is January 31, 2015 and not January 31, 2014. The subsequent remedial amendment cycle is shortened accordingly but the submission period deadline remains January 31, 2019.

Example 21: Employer Z, whose EIN ends with a 2, maintains Plan V. Plan V is a defined contribution plan and is an adoption of a VS plan as of January 1, 2011. The VS specimen plan is timely submitted for the second six-year remedial amendment cycle by the practitioner on or before January 31, 2012. The VS practitioner receives an advisory letter dated January 31, 2014 for the VS specimen plan. Generally, Employer Z will have until January 31, 2016 (unless otherwise provided by the Service) to adopt the approved VS plan and to have such adoption be considered timely under § 401(b) of the Code.

On November 15, 2013, Employer Z adopts an amendment to Plan V that creates an employee stock ownership plan (more than one year after Employer Z adopted Plan V). Although Employer Z adopts this amendment timely and in good faith with the intent of maintaining the qualified status of Plan V, this amendment changes the provisions of the VS plan to create a type of plan that is not allowed in the VS program. Since Employer Z has amended the VS plan to incorporate a type of plan for which the Service will not issue an advisory letter, Employer Z submits a determination letter application for Plan V by November 20, 2013 using Form 5300, *Application for Determination for Employee Benefit Plan*, and pays the higher user fee. The Service would use the 2012 Cumulative List in its review of the determination letter submission. Employer Z receives a favorable determination letter dated November 20, 2014. Employer Z's subsequent remedial amendment cycle is the first five-year cycle, as determined under section 9 or 10 of this revenue procedure that ends after the closing of the six-year cycle in which the determination letter application was submitted; thus, the next five-year remedial amendment cycle ends January 31, 2018.

Example 22: Same as Example 21, except that Employer Z adopts an amendment to Plan V that creates an employee stock ownership plan in 2011, the same year Employer Z adopted Plan V. Since Employer Z amended the VS plan to incorporate a type of plan for which the Service will not issue an advisory letter, within one year of adopting the VS plan, the plan is an individually designed plan that is not eligible for the six-year remedial amendment cycle. Employer Z must submit a determination letter application for Plan V during the applicable submission period for Cycle B, February 1, 2012 through January 31, 2013, using Form 5300, *Application for Determination for Employee Benefit Plan*, and pay the higher user fee. The Service would use the 2011 Cumulative List in its review of the determination letter submission.

SECTION 20. OFF-CYCLE FILING

.01 If an opinion or advisory letter application for a new pre-approved plan (a plan created after the submission period for the applicable six-year cycle) is submitted outside of the submission period within an applicable six-year cycle, the application is filed "off-cycle". The application will be reviewed using the Cumulative List the Service would have used if the plan had been submitted as an on-cycle plan during the most recently expired submission period that would have applied for that particular type of plan.

(1) An opinion or advisory letter with respect to an application filed off-cycle is not retroactive and therefore may not be relied upon by sponsors, practitioners, or adopting employers for the period prior to the date of the submission for approval.

(2) As described in sections 16.03 and 16.04, the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans when the review of a cycle for pre-approved plans has neared completion. Depending on the length of the review process, it is expected that this date will give virtually all employers approximately a two-year window to adopt their updated plans. However, the adoption period for employers to adopt such new plans could be shorter than this approximate two-year window, depending on when the Service finishes the review and approves such new plans. In any event, for adopting employers of such new plans to be eligible for the applicable six-year cycle, sponsors or practitioners must submit new pre-approved plans prior to the beginning of such announced adoption period, to give the Service time to review such plans and to provide time for adopting employers to adopt such plans.

(3) Adopting employers must adopt such plans within the adoption period and must file a Form 5307 or Form 5300 as appropriate. For example, employers adopting new defined contribution pre-approved plans created after January 31, 2006, will be eligible for the six-year cycle if such opinion or advisory letter applications for new pre-approved plans are submitted before the beginning of the

announced adoption period for employers to adopt such plans (although the letter will not be retroactively effective prior to the date of the submission for approval during the first six-year cycle in which a new pre-approved plan is adopted, as described above).

.02 If a pre-approved plan in existence prior to the submission deadline for the six-year remedial amendment cycle was submitted for an application for an opinion or advisory letter by the applicable deadline, then the sponsor or practitioner of that pre-approved plan may not also submit an application for an off-cycle opinion or advisory letter.

.03 Future guidelines will address how the Service will process a pre-approved plan in existence prior to the submission deadline for the six-year remedial amendment cycle that was not submitted for an opinion or advisory letter by the applicable submission deadline.

.04 The Service has the discretion to determine whether a sponsor or practitioner is subject to section 20.03 or is submitting an application for a new pre-approved plan under section 20.01.

Example 23: Sponsor S submits an application for an opinion letter for a new defined contribution M&P pre-approved plan, Plan Y, on December 31, 2007. This is after the submission period that ended on January 31, 2006 for the current cycle, and, under the facts of this example, before the beginning of the approximate two-year window that the Service will announce for employers to adopt pre-approved plans. Sponsor S's application will be reviewed using the 2004 Cumulative List. The opinion letter will only provide reliance for the period on or after December 31, 2007. An adopting employer may not rely on the opinion letter issued for Plan Y to extend the remedial amendment period for the employer's plan to the end of the initial six-year remedial amendment cycle, regardless of whether the employer adopts Plan Y during the approximate two-year period within the six-year remedial amendment cycle that the Service announces for employers to adopt the newly approved plans (announced adoption period). Thus, an employer adopting Plan Y to restate a plan that was established prior to December 31, 2007 would generally need to file a timely determination letter application as an individually designed plan in order to have reliance for the period prior to December 31, 2007.

SECTION 21. EFFECT ON OTHER DOCUMENTS

.01 Generally, this revenue procedure is effective on June 13, 2007.

.02 Rev. Proc. 2005–66 is clarified, modified and superseded. Rev. Proc. 2005–16 is modified.

.03 Notwithstanding section 21.02, if an employer, sponsor or practitioner (entity) has made a determination with respect to a particular plan based on a reasonable and good faith interpretation of Rev. Proc. 2005–66 that the plan is not a Cycle A plan, and under this revenue procedure the plan is a Cycle A plan, which should have been submitted to the Service by January 31, 2007, then the entity has six months from July 9, 2007 to submit the plan to the Service. The plan will be considered on-cycle for Cycle A and will be reviewed by the Service using the annual Cumulative List based on the date of the determination letter submission. Thus, for example, a plan submitted on July 31, 2007 will be reviewed on the basis of the 2006 Cumulative List and the plan will be considered to have been submitted within the extended remedial amendment period.

.04 The Service will make the final determination in all cases as to whether the determination of the entity with respect to a particular plan is reasonable and in good faith, including whether it is practicable for the entity to change the determination to be consistent with this revenue procedure. An entity will not be considered to have made a determination under a reasonable and good faith interpretation of Rev. Proc. 2005–66 if it did not comply with the provisions of Rev. Proc. 2005–66 or this revenue procedure, and the reason for not complying is unrelated to the above changes (*e.g.*, missing the deadline to submit an application for an opinion or advisory letter to the Service is unrelated to the changes).

DRAFTING INFORMATION

The principal author of this revenue procedure is Ingrid Grinde of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans taxpayer assistance answering service at 1–877–829–5500 (a toll-free number) between the hours of 8:30 a.m. and 4:30 p.m., Eastern time, Monday through Friday or Ms. Grinde at *RetirementPlanQuestions@irs.gov*._

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Grantor Retained Interest Trusts—Application of Sections 2036 and 2039

REG–119097–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations providing guidance on the portion of a trust properly includible in a grantor's gross estate under Internal Revenue Code (Code) sections 2036 and 2039 if the grantor has retained the use of property in a trust or the right to an annuity, unitrust, or other income payment from such trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 5, 2007. Outlines of topics to be discussed at the public hearing scheduled for September 26, 2007, must be received by September 5, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–119097–05), Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to the Courier's Desk, Internal Revenue Service, Attn: CC:PA:LPD:PR (REG–119097–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Alternatively, submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–119097–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–119097–05). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa M. Melchiorre, (202) 622–7830; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622–7180 (not toll-free numbers) or e-mail at *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations provide guidance on what portion of a trust is includible in the deceased grantor's gross estate under section 2036 if the grantor retained the right to use property in the trust or the right to receive from that trust an annuity, unitrust, or other income payment for the grantor's life, for any period not ascertainable without reference to the grantor's death, or for any period that does not in fact end before the grantor's death. In addition, the proposed regulations provide guidance on the possible application of section 2039 to trusts in which the decedent has retained the use of property held in the trust or has retained an annuity, unitrust, or other income interest that is includible in the decedent's gross estate under section 2036. These trusts include without limitation certain charitable trusts (collectively CRTs) such as charitable remainder annuity trusts (CRATs) within the meaning of section 664(d)(1), charitable remainder unitrusts (CRUTs) within the meaning of section 664(d)(2) or (d)(3), and charitable remainder trusts that do not qualify under section 664, as well as other trusts established by a grantor (collectively GRTs) such as grantor retained annuity trusts (GRATs), grantor retained unitrusts (GRUTs), and various forms of grantor retained income trusts (GRITs), such as qualified personal residence trusts (QPRTs) and personal residence trusts (PRTs). A CRT is within the scope of these proposed regulations whether or not the CRT meets the qualifications of sections 664(d)(1), (2), or (3) and a GRT is within the scope of these proposed regulations whether or not the grantor's retained interest is a "qualified interest" as defined in section 2702(b). This guidance does not apply to trusts or other contractual arrangements arising by reason of a decedent's employment and generally does not apply to annuities purchased by the decedent, as these types of interests fall within the ambit of section 2039.

Under section 2036(a), a decedent's gross estate includes the value of any interest in property transferred by the decedent in which the decedent retained for the decedent's life, for any period not ascertainable without reference to the decedent's death, or for any period that does not in fact end before the decedent's death, either the possession or enjoyment of the property or a right to the income from the property, or the right (either alone or with another) to designate the persons who may possess or enjoy the property or its income. Section 20.2036–1(a) provides generally that, if the decedent retained or reserved an interest with respect to all of the property transferred by the decedent, the amount to be included in the gross estate under section 2036 is the value of the entire property on the date of death. If the decedent retained a right with respect to only part of the property transferred, the amount to be included in the decedent's gross estate under section 2036 is the corresponding proportionate amount of the corpus. Rev. Rul. 76–273, 1976–2 C.B. 268, and Rev. Rul. 82–105, 1982–1 C.B. 133 (See §601.601(d)(2)), generally provide that the portion of the corpus of a CRUT and CRAT includible in the decedent's gross estate under section 2036 is that portion of the trust corpus necessary to generate a return sufficient to provide the decedent's retained annuity or unitrust payment.

Rev. Rul. 76–273 considers a situation where the decedent created an inter vivos trust that provided for a stated unitrust percentage of 6 percent to be paid each year to the decedent during life. At the decedent's death, the remainder is to be paid to a charitable organization. The revenue

ruling concludes that, for purposes of section 2036(a), the portion of the value of the trust corpus includible in the decedent's gross estate is the portion necessary to yield (at the then current interest rate specified under the applicable regulations) the amount of the annual unitrust payment in perpetuity. Based upon the valuation rules and interest rate assumptions specified in §20.2031–10 (the regulations applicable at the time the ruling was issued), the revenue ruling provides the following formula to be used to determine this includible portion of the trust corpus: equivalent income interest rate divided by the interest rate mandated by the applicable regulations at the date of death, where the equivalent income interest rate = adjusted payout rate/1 minus adjusted payout rate. The result, however, is limited to 100 percent of the trust corpus. (Since the issuance of this revenue ruling, the regulations (§20.2031–7(d)(1)) have been changed to instead require the use of the section 7520 interest rate in lieu of the rate specified in §20.2031–10). The revenue ruling concludes that, because the equivalent income interest of the unitrust payment exceeds the equivalent income interest required to produce that unitrust payment, the grantor retained an interest in the entire corpus of the trust, and thus the entire trust corpus is includible in the deceased grantor's gross estate under section 2036.

Rev. Rul. 82–105 considers a situation where the decedent created an intervivos CRAT, pursuant to which the decedent retained the right to receive a fixed annuity for life. The ruling confirms that the decedent's retained annuity represents the retained right to receive all of the income from all or a specific portion of the trust for purposes of section 2036. That portion of the trust corpus with respect to which the decedent retained a right to receive all of the income is properly includible in the decedent's gross estate under section 2036(a)(1). Under the ruling, the amount of the corpus with respect to which the decedent retained the income is that amount of corpus that would be sufficient to yield the annual annuity based on the assumed rate of return prescribed by the regulations as of the applicable valuation date. The ruling prescribes the following formula for this determination: (Annual Annuity) / (Assumed Rate of Return) = Amount Includible. Assuming a rate of return of 6 percent, as specified under §20.2031–10 (the regulation applicable at the time the ruling was issued), the ruling concludes that only a portion of the trust's corpus is includible in the deceased grantor's gross estate. (Since the issuance of this revenue ruling, the regulations (§20.2031–7(d)(1)) have been changed to instead require the use of the section 7520 interest rate in place of the rate specified in §20.2031–10.) Rev. Rul. 82–105 expressly qualifies this conclusion by stating that the ruling does not consider the amount, if any, that may be includible in the gross estate under any other provisions of the Code.

Section 2039(a) provides that a decedent's gross estate includes the value of an annuity or other payment under any form of contract or agreement (other than an insurance policy on the decedent's life) receivable by any beneficiary by reason of surviving the decedent if, under the contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or other payment, for the decedent's life or for any period not ascertainable without reference to the decedent's death, or for any period that does not in fact end before the decedent's death.

Section 2039(b) provides, in part, that the amount includible in the decedent's gross estate is limited to that portion of the value of the annuity or other payment receivable under the contract or agreement as is proportionate to the portion of the purchase price of the contract or agreement that was contributed by the decedent. Section 20.2039–1(b)(1) provides, in part, that the term "annuity or other payment," as used with respect to both the payment receivable by the decedent and by the beneficiary, has reference to one or more payments extending over any period of time, whether the payments are equal or unequal, conditional or unconditional, periodic or sporadic. The term "contract or agreement" includes any arrangement, understanding, or plan, or any combination of them, arising by reason of the decedent's employment. Section 20.2039–1(b)(1).

As is acknowledged in Rev. Rul. 82–105, section 2036 as well as other sections of the Code might apply to the same interest or trust for purposes of the Federal estate tax. Although either section 2036 or section 2039 may be applied to include at least some portion of a trust in the decedent's gross estate if the decedent transfers property during life to a trust and retains the right to use the trust's property or the right to an annuity, unitrust, or other payment from the trust, the amount includible may differ depending upon which section is applied for this purpose.

Explanation of Provisions

The proposed regulations amend §20.2036–1 to incorporate the guidance provided in Rev. Rul. 76–273 and Rev. Rul. 82–105. The proposed regulations provide that, if a decedent transfers property during life to a trust and retains the right to an annuity, unitrust, or other income payment from, or retains the use of an asset in, the trust for the decedent's life, for a period that does not in fact end before the decedent's death, or for a period not ascertainable without reference to the decedent's death, the decedent has retained the right to income from all or a specific portion of the property transferred as described in section 2036. The portion of the trust corpus includible in the decedent's gross estate is that portion of the trust corpus, valued as of the decedent's death (or the alternate valuation date, if applicable) necessary to yield that annual payment (or use) using the appropriate section 7520 interest rate. In this regard, because the specific portion of corpus includible in the gross estate is properly determined as of the decedent's death, the appropriate section 7520 rate is the rate in effect on the decedent's date of death (or on the alternate valuation date, if applicable). The proposed regulations provide both rules and examples for calculating the amount of trust corpus to be included in a deceased grantor's gross estate under section 2036 in such a case.

The IRS and Treasury Department believe that in many cases both section 2036 and section 2039 may be applicable to these annuity and unitrust interests and to such other payments retained by a deceased grantor. Although the language of section 2039 is broad enough to include all or a portion of a trust's corpus if the grantor retains an annuity or unitrust interest in, or other payments from, a trust, the IRS and Treasury Department believe that, in the interest of ensuring similar tax treatment for similarly situated taxpayers, it

is appropriate in this circumstance to provide regulatory rules under which only one of these two potentially applicable Code sections (section 2036 and section 2039) will be applied in the future. For the reasons mentioned below, the IRS and Treasury Department have concluded that section 2036 (and therefore, when applicable, section 2035), rather than section 2039, will be applied in the future to these interests. First, section 2039 appears to have been intended to address annuities purchased by or on behalf of the decedent and annuities provided by the decedent's employer. Second, the interests retained by grantors in the types of trusts described in this guidance are more similar in most relevant respects to the interests addressed under section 2036 than those most clearly addressed under section 2039. Accordingly, the proposed regulations also amend §20.2039–1(b)(1) by providing that section 2039 shall not be applied to an annuity, unitrust, or other payment retained by a deceased grantor in a CRT or GRT.

Although these proposed regulations provide guidance as to which section of the Code (specifically, section 2036 or section 2039) is to be used in certain circumstances when each of those sections applies to the same CRT or GRT, these proposed regulations should not be construed to imply that only one section of the Code may apply to a particular situation or interest. These proposed regulations are not intended to foreclose the possibility that any applicable section of the Code (sections 2035 through 2039, or any other section) properly may be applied in the future by the IRS in appropriate circumstances beyond those described in these proposed regulations. (For example, although section 2039 generally will apply to govern the includability of annuities purchased by or on behalf of the decedent and annuities provided by the decedent's employer in the decedent's gross estate, section 2036 may instead be applied if the facts and circumstances indicate that the annuity constituted a retained interest in the property exchanged for that annuity.)

Proposed Effective Date

The first, second, and fourth sentences in §20.2039–1(a) and the provisions in §20.2036–1(a)(1), (a)(2), and (c)(1)(i) are applicable to the estates of decedents dying after August 16, 1954. The fifth sentence of §20.2039–1(a) is applicable to the estates of decedents dying on or after October 27, 1972, and to the estates of decedents for which the period for filing a claim for credit or refund of an estate tax overpayment ends on or after October 27, 1972. The provisions of §20.2036–1(c)(1)(ii) and (2), §20.2039–1(e), and the third, sixth, and seventh sentences of §20.2039–1(a) apply to the estates of decedents for which the valuation date of the gross estate is on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department also request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 26, 2007 in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must use the main building entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written (a signed original and eight (8) copies) or electronic comments by September 5, 2007, and an outline of the topics to be discussed and the time to be devoted to each topic by September 5, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Theresa M. Melchiorre, Office of Chief Counsel, IRS.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 20.2036–1 is amended by:

1. Redesignating paragraphs (a)(i) and (a)(ii) as paragraphs (a)(1) and (a)(2), respectively.

2. Designating the undesignated text following newly-designated paragraph (a)(2) as paragraph (c)(1)(i) and adding new paragraph headings.

3. Adding paragraphs (c)(1)(ii), (c)(2), and (c)(3).

The additions read as follows:

§20.2036–1 Transfers with retained life estate.

* * * * *

(c) *Retained or reserved interest*—(1) *Amount included in gross estate*—(i) *In general.* * * *

(ii) *Example.* The application of paragraph (c)(1)(i) of this section is illustrated in the following example:

Example. In 2001, Decedent (D) creates an irrevocable intervivos trust. The terms of the trust provide that all of the trust's income is to be paid to D and E, D's spouse who is a US citizen, in equal shares during their joint lives and, on the death of either of them, all of the income is to be paid to the survivor of them. On the death of the survivor of D and E, the remainder is to be paid to another individual, F. In 2006, D dies with E still surviving. A portion of the trust's corpus is includible in D's gross estate because D retained the right to receive a portion of the income from the trust for a period that does not in fact end before D's death. The portion of the trust's corpus includible in D's gross estate bears the same ratio to the entire corpus as D's income interest in the trust bears to the entire income interest in the trust. Therefore, in this case, because D and E share equally in the trust's income, 50 percent of the trust's corpus is includible in D's gross estate under section 2036. If instead E had predeceased D, D would have died while entitled to all of the income from the trust, so that the entire trust corpus would have been includible in D's gross estate under section 2036.

(2) *Retained annuity and unitrust interests in trusts*—(i) *In general.* This paragraph (c)(2) applies to a grantor's retained use of an asset held in trust or a retained annuity, unitrust, or other income interest in any trust (other than a trust constituting an employee benefit) including without limitation the following (collectively referred to in this paragraph (c)(2) as "trusts"): certain charitable trusts (collectively CRTs) such as a charitable remainder annuity trust (CRAT) within the meaning of section 664(d)(1), a charitable remainder unitrust (CRUT) within the meaning of section 664(d)(2) or (d)(3), and any charitable remainder trust that does not qualify under section 664(d), as well as other trusts established by a grantor (collectively GRTs) such as a grantor retained annuity trust (GRAT), a grantor retained unitrust (GRUT), and various other forms of grantor retained income trusts (GRITs), whether or not the grantor's retained interest is a qualified interest as defined in section 2702(b), including without limitation qualified personal residence trusts (QPRTs) and personal residence trusts (PRTs). If a decedent transferred property into such a trust, and retained or reserved the right to use such property or the right to an annuity, unitrust, other income interest in such trust with respect to the property so transferred by the decedent, or to determine the persons who may possess or enjoy the property or its income, for the decedent's life, for any period not ascertainable without reference to the decedent's death, or for a period that does not in fact end before the decedent's death, then the decedent's right to use the property or retained annuity, unitrust, or other income interest (or to designate the beneficiaries of the property) represents the retained right to receive all of the income from all or a specific portion of the trust for purposes of section 2036. The portion of the trust's corpus includible in the decedent's gross estate for Federal estate tax purposes is that portion of the trust corpus necessary to yield the decedent's retained use or retained annuity, unitrust, other income payment as determined in accordance with §20.2031–7 (or §20.2031–7A, if applicable).

(ii) *Examples.* The application of paragraph (c)(2)(i) of this section is illustrated in the following examples:

Example 1. (i) In 2000, Decedent (D) transferred \$100,000 to a trust that qualifies as a CRAT under section 664(d)(1). The trust agreement provides for an annuity of \$12,000 to be paid each year to D for D's life, then to D's child (C) for C's life, with the remainder to be distributed upon the survivor's death to N, a charitable organization described in sections 170(c), 2055(a), and 2522(a). The annuity is payable to D or C, as the case may be, annually on each December 31st. D died in 2006, survived by C who was then age 40. On D's death, the value of the trust assets was \$300,000 and the section 7520 interest rate was 6 percent. D's executor did not elect to use the alternate valuation date.

(ii) The amount of corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036, is that amount of corpus necessary to yield the annual annuity payment to D. In this case, the formula for determining the amount of corpus necessary to yield the annual annuity payment to D is: annual annuity / section 7520 interest rate = amount includible under section 2036. The amount of corpus necessary to yield the annual annuity is \$12,000 / .06 = \$200,000. Therefore, \$200,000 is includible in D's gross estate under section 2036(a)(1). (The result would be the same if D had irrevocably relinquished D's annuity interest no more than 3 years prior to D's death because of the application of section 2035.) D's estate is entitled to a charitable deduction under section 2055 for the present value of N's remainder interest in the CRAT. The applicable annuity factor (based on C's age on D's death and the section 7520 rate applicable on that date) is 14.1646. Therefore, the present value of the annuity is \$169,975.20 (14.1646 x \$12,000). As a result, the allowable charitable deduction for D's estate is \$30,024.80 (\$200,000 - \$169,975.20). Under the facts presented, the Internal Revenue Service (IRS) will not seek (and the estate will not be permitted) to include under section 2039 any amount in D's gross estate by reason of this retained annuity. See §20.2039–1(e).

Example 2. (i) D transferred \$100,000 to a GRAT in which D's annuity is a qualified interest described in section 2702(b). The trust agreement provides for an annuity of \$12,000 per year to be paid to D for a term of ten years or until D's earlier death. The annuity amount is payable at the end of each month in twelve equal installments. At the expiration of the term of years or on D's earlier death, the remainder is to be distributed to C, D's child. No additional contributions were made to the trust after D's transfer at the creation of the trust. D dies prior to the expiration of the ten-year term. On the date of D's death, the value of the trust assets was \$300,000 and the section 7520 interest rate was 6 percent. D's executor did not elect to use the alternate valuation date.

(ii) The amount of corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036, is that amount of corpus necessary to yield the annual annuity payment to D. In this case, the formula for determining the amount of corpus necessary to yield the annual annuity payment to D is: annual annuity (adjusted for monthly payments) / section 7520 interest rate = amount includible under section 2036. The Table K adjustment factor for monthly annuity payments in this case is 1.0272. Thus, the amount of corpus necessary to yield the annual annuity is (\$12,000 x 1.0272) / .06 = \$205,440. Therefore, \$205,440 is includible in D's gross estate under section 2036(a)(1). Under the facts presented, the IRS will not seek (and the estate will not be permitted) to include under section 2039 any amount in D's gross estate by reason of this retained annuity. See §20.2039–1(e).

Example 3. (i) In 2000, D created a CRUT within the meaning of section 664(d)(2). The trust instrument directs the trustee to hold, invest, and reinvest the corpus of the trust and to pay to D for D's life, and then to D's child (C) for C's life, in equal quarterly installments payable at the end of each calendar quarter, an amount equal to 6 percent of the fair market value of the trust as valued on December 15 of the prior taxable year of the trust. At the termination of the trust, the then corpus, together with any and all the accrued income, is to be distributed to N, a charitable organization described in sections 170(c), 2055(a), and 2522(a). D died in 2006, survived by C, who was then age 55. The value of the trust assets on D's death was \$300,000 and D's executor did not elect to use the alternate valuation date.

(ii) The amount of the corpus with respect to which D retained the right to the income, and thus the amount includible in D's gross estate under section 2036, is that amount of corpus necessary to yield the unitrust payments. In this case, such amount of corpus is determined by dividing the trust's equivalent income interest rate by the section 7520 rate (which was 6 percent at the time of D's death). The equivalent income interest rate is determined by dividing the trust's adjusted payout rate by the excess of 1 over the adjusted payout rate. Based on §1.664–4(e)(3) of the Income Tax Regulations, the appropriate adjusted payout rate for the trust at D's death is 5.786 percent (6 percent x .964365). Thus,

the equivalent income interest rate is 6.141 percent (5.786 percent / (1 - 5.786 percent)). The ratio of the equivalent interest rate to the assumed interest rate under section 7520 is 102.35 percent (6.141 percent / 6 percent). Because this exceeds 100 percent, D's retained payout interest exceeds a full income interest in the trust, and D effectively retained the income from all the assets transferred to the trust. Accordingly, because D retained for life an interest at least equal to the right to the income from all the property transferred by D to the CRUT, the entire value of the corpus of the CRUT is includible in D's gross estate under section 2036(a)(1). D's estate is entitled to a charitable deduction under section 2055 for the present value of N's remainder interest in the CRAT. The remainder factor (based on C's age at D's death, the section 7520 rate in effect on D's death, and the timing and frequency of the payments) is 0.28253. Therefore, the charitable deduction allowable to D's estate is $84,759 ($300,000 x 0.28253). Under the facts presented, the IRS will not seek (and the estate will not be permitted) to include under section 2039 any amount in D's gross estate by reason of D's retained unitrust interest. See §20.2039–1(e).

(iii) If instead D had retained the right to a unitrust amount having an adjusted payout for which the corresponding equivalent interest rate would be less than the 6 percent assumed interest rate of section 7520, then a correspondingly reduced proportion of the trust corpus would be includible in D's gross estate under section 2036(a)(1). Alternatively, if the interest retained by D was instead only one-half of the 6 percent unitrust interest, the computation of the portion of the trust includable in D's gross estate (set forth in *Example 3* (ii)) would be reduced by one-half. In each case, the amount of the estate's charitable deduction for the remainder interest in the trust also would be reduced. All of the results in this *Example 3* (except those relating to the charitable deduction) would be the same if the trust was a GRUT instead of a CRUT.

Example 4. During D's life, D established a 15-year GRIT for the benefit of individuals who are not members of D's family within the meaning of section 2704(c)(2). D retained the right to receive all of the net income from the GRIT, payable annually, during the GRIT's term. D died during the third year of the GRIT term. D's executor did not elect to use the alternate valuation date. In this case, the GRIT's corpus is includible in D's gross estate under section 2036 because D retained the right to receive all of the income from the GRIT for a period that did not in fact end before D's death. If instead, D had retained the right to receive 60 percent of the GRIT's net income, then 60 percent of the GRIT's corpus would have been includible in D's gross estate under section 2036.

Example 5. D transfered D's personal residence to a trust that met the requirements of a qualified personal residence trust (QPRT) as set forth in §25.2702–5(c) of this chapter. Pursuant to the terms of the QPRT, D retained the right to use the residence for 10 years or until D's prior death. D died before the end of the term. D's executor did not elect to use the alternate valuation date. In this case, the fair market value of the QPRT's assets on the date of D's death are includible in D's gross estate under section 2036 because D retained the right to use the residence for a period that did not in fact end before D's death.

(3) *Effective dates.* Paragraphs (a)(1), (a)(2), and (c)(1)(i) of this section are applicable to the estates of decedents dying after August 16, 1954. Paragraphs (c)(1)(ii) and (c)(2) of this section apply to the estates of decedents for which the valuation date of the gross estate is on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 3. Section 20.2039–1 is amended by:

1. Revising paragraph (a).
2. Adding a new paragraph (e).

The revision and addition reads as follows:

§20.2039–1 Annuities.

(a) *In general.* A decedent's gross estate includes under section 2039(a) and (b) the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under certain agreements or plans to the extent that the value of the annuity or other payment is attributable to contributions made by the decedent or his employer. Section 2039(a) and (b), however, has no application to an amount which constitutes the proceeds of insurance under a policy on the decedent's life. Paragraph (b) of this section describes the agreements or plans to which section 2039(a) and (b) applies; paragraph (c) of this section provides rules for determining the amount includible in the decedent's gross estate; paragraph (d) of this section distinguishes proceeds of life insurance; and paragraph (e) of this section distinguishes annuity, unitrust, and other income interests retained by a decedent in certain trusts. The fact that an annuity or other payment is not includible in a decedent's gross estate under section 2039(a) and (b) does not mean that it is not includible under some other section of part III of subchapter A of chapter 11. However, see section 2039(c) and (d) and §20.2039–2 for rules relating to the exclusion from a decedent's gross estate of annuities and other payments under certain "qualified plans." Further, the fact that an annuity or other payment may be includible under section 2039(a) will not preclude the application of another section of chapter 11 with regard to that interest. For annuity interests in trust, see paragraph (e)(1) of this section.

* * * * *

(e)(1) *No application to certain trusts.* Section 2039 shall not be applied to include in a decedent's gross estate all or any portion of a trust (other than a trust constituting an employee benefit, but including those described in the following sentence) if the decedent retained a right to use property of the trust or retained an annuity, unitrust, or other income interest in the trust, in either case as described in section 2036. Such trusts include without limitation the following (collectively referred to in this paragraph (e)(1) as "trusts"): certain charitable trusts (collectively CRTs) such as a charitable remainder annuity trust (CRAT) within the meaning of section 664(d)(1), a charitable remainder unitrust (CRUT) within the meaning of section 664(d)(2) or (d)(3), and any other charitable remainder trust that does not qualify under section 664(d), as well as other trusts established by a grantor (collectively GRTs) such as a grantor retained annuity trust (GRAT), a grantor retained unitrust (GRUT), and various forms of grantor retained income trusts (GRITs), whether or not the grantor's retained interest is a qualified interest as defined in section 2702(b), including without limitation qualified personal residence trusts (QPRTs) and personal residence trusts (PRTs). For purposes of determining the extent to which a retained interest causes all or a portion of a trust to be included in a decedent's gross estate, see §20.2036–1(c)(1), (2), and (3).

(2) *Effective date.* The first, second, and fourth sentences in paragraph (a) of this section are applicable to the estates of decedents dying after August 16, 1954. The fifth sentence of paragraph (a) of this section is applicable to the estates of decedents dying on or after October 27, 1972, and to the estates of decedents for which the period for filing a claim for credit or refund of an estate tax overpayment ends on or after October 27, 1972. The third, sixth, and seventh sentences of paragraph (a) of this section and this paragraph (e) are applicable to the estates of decedents for which the valuation date of the gross estate is on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 7, 2007, 72 F.R. 31487)

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Films Under Section 199

REG–103842–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed amendments to the regulations involving the deduction for income attributable to domestic production activities under section 199. The proposed amendments affect taxpayers who produce qualified films under section 199(c)(4)(A)(i)(II) and (c)(6) and taxpayers who are members of an expanded affiliated group under section 199(d)(4). This document also contains a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 5, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 2, 2007, must be received by September 11, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–103842–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–103842–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS REG–103842–07). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning §1.199–3(k) of the proposed regulations, David McDonnell, at (202) 622–3040; concerning §1.199–7 of the proposed regulations, Ken Cohen (202) 622–7790; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard Hurst, at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to §§1.199–3(k) and 1.199–7 of the Income Tax Regulations (26 CFR Part 1). Section 1.199–3(k) relates to the definition of qualified film produced by the taxpayer under section 199(c)(4)(A)(i)(II) and (c)(6) of the Internal Revenue Code (Code) and §1.199–7 involves expanded affiliated groups under section 199(d)(4). Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25), section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345), and section 401 of the Tax Relief and Health Care Act of 2006 (Public Law 109–432, 120 Stat. 2922).

General Overview

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of (A) the taxpayer's domestic production gross receipts (DPGR) for such taxable year, over (B) the sum of (i) the cost of goods sold (CGS) that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under section 199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i) provides that the term DPGR means the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of (I) qualifying production property (QPP) that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States; (II) any qualified film produced by the taxpayer; or (III) electricity, natural gas, or potable water produced by the taxpayer in the United States.

Section 199(c)(6) defines a qualified film to mean any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to production of the property is compensation for services performed in the United States by actors, production personnel, directors, and producers. The term does not include property with respect to which records are required to be maintained under 18 U.S.C. 2257 (generally, films, videotapes, or other matter that depict actual sexually explicit conduct and are produced in whole or in part with materials that have been mailed or shipped in interstate or foreign commerce, or are shipped or transported or are intended for shipment or transportation in interstate or foreign commerce).

Section 199(d)(4)(A) provides that all members of an expanded affiliated group (EAG) are treated as a single corporation for purposes of section 199. Under section 199(d)(4)(B), an EAG is an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to section 1504(b)(2) and (4).

Section 199(d)(8) authorizes the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199, including regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with

respect to any activity described in section 199(c)(4)(A)(i).

Explanation of Provisions

Qualified Film Produced by the Taxpayer

On June 1, 2006, final regulations (T.D. 9263, 2006–1 C.B. 1063) under section 199 were published in the **Federal Register** (71 FR 31268). Subsequent to the publication of the final regulations, the IRS and Treasury Department became aware that the definition of a qualified film produced by a taxpayer as outlined in the final regulations may not be consistent with the statute. Under section 199(c)(4)(A)(i)(II), a taxpayer's gross receipts qualify as DPGR if the receipts are derived from any lease, rental, license, sale, exchange, or other disposition of any qualified film (as defined in section 199(c)(6)) produced by the taxpayer. A film must be both a "qualified film" under section 199(c)(6) and "produced by the taxpayer" under section 199(c)(4)(A)(i)(II) in order for the gross receipts to qualify as DPGR. Section 1.199–3(k)(5) of the final regulations addresses these two requirements by adding "by the taxpayer" to the not-less-than-50-percent-of-the-total-compensation requirement under §1.199–3(k)(1). However, under the test provided in §1.199–3(k)(5) of the final regulations, a film that was produced entirely within the United States could fail to qualify for the section 199 deduction if less than 50 percent of the total compensation relating to production was paid "by the taxpayer."

The proposed regulations more closely follow the statutory language in section 199(c)(6) by revising the fraction in §1.199–3(k)(5) for determining the not-less-than-50-percent-of-the-total-compensation requirement under §1.199–3(k)(1). Under the fraction set forth in the proposed regulations, the numerator of the revised fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. The revised fraction essentially compares (in the numerator) the sum of the compensation for services paid by the taxpayer for services performed in the United States and the compensation for services paid by others for services performed in the United States to (in the denominator) the sum of the total compensation for services paid by the taxpayer for services and the total compensation for services paid by others for services regardless of location. The proposed regulations also clarify in §1.199–8(a) that, for purposes of §§1.199–1 through 1.199–9, use of terms such as "payment," "paid," "incurred," or "paid or incurred" is not intended to provide any specific rule based upon the use of one term versus another. In general, the use of the term "payment," "paid," "incurred," or "paid or incurred" is intended to convey the appropriate standard under the taxpayer's method of accounting.

Under §1.199–3(k)(6) of the proposed regulations, a film that is a qualified film under §1.199–3(k)(1) will be treated as "produced by the taxpayer" for purposes of section 199(c)(4)(A)(i)(II) if the production activity performed by the taxpayer is substantial in nature within the meaning of §1.199–3(g)(2). The special rules of §1.199–3(g)(4) regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer's production activity is substantial in nature. Section 1.199–3(g)(2) and (4) are applied by substituting the term "qualified film" for QPP and disregarding the requirement that the production activity must be within the United States. Thus, a qualified film will be treated as produced by the taxpayer if the production of the qualified film by the taxpayer is substantial in nature taking into account all of the facts and circumstances, including the relative value added by, and relative cost of, the taxpayer's production activity, the nature of the qualified film, and the nature of the production activity that the taxpayer performs.

The rules provided in §1.199–3(k)(5) of the proposed regulations closely follow the statutory language in section 199(c)(6) by referencing all compensation for services related to the production as opposed to a more limited "by the taxpayer" compensation test. Commentators have expressed concern over the difficulty of obtaining information related to the compensation paid by others. In response to this concern, the IRS and Treasury Department have provided a safe harbor in §1.199–3(k)(7) of the proposed regulations provides a safe harbor that will treat a film as a qualified film if not less than 50 percent of the total compensation for services paid by the taxpayer is compensation for services performed in the United States. The safe harbor further provides that a qualified film will be treated as produced by the taxpayer if the taxpayer satisfies the safe harbor in §1.199–3(g)(3) with respect to the qualified film, which requires that the direct labor and overhead costs incurred by the taxpayer to produce the qualified film within the United States account for 20 percent or more of the total costs of the film.

Similar to §1.199–3(k)(6) of the proposed regulations, the special rules of §1.199–3(g)(4) regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer satisfies §1.199–3(g)(3). Section 1.199–3(g)(3) and (4) are applied by substituting the term "qualified film" for QPP but not disregarding the requirement that the direct labor and overhead of the taxpayer to produce the qualified film must be within the United States. Thus, a taxpayer will be treated as having produced a qualified film if, in connection with the qualified film, the direct labor and overhead of the taxpayer to produce the qualified film within the United States account for 20 percent or more of the taxpayer's CGS of the qualified film, or in a transaction without CGS (for example, a lease, rental, or license) account for 20 percent or more of the taxpayer's "unadjusted depreciable basis" (as defined in §1.199–3(g)(3)(ii)) in the qualified film.

Expanded Affiliated Groups

After issuance of the final regulations, several commentators noted that §1.199–7(e), *Example 10*, of the final regulations misapplies §1.1502–13 of the consolidated return regulations. In *Example 10*, a member of a consolidated group sells QPP to another member of the consolidated group. Before the QPP is sold to an unrelated party, the purchasing corporation is disaffiliated from the consolidated group. *Example 10* provides that neither the selling corporation nor the purchasing corporation has DPGR. After further consideration, the IRS and Treasury Department have determined that *Example 10* does not properly apply §1.1502–13 of the consolidated return regulations and that both the selling corporation and the

purchasing corporation have DPGR in the facts described. Accordingly, the proposed regulations remove *Example 10* of the final regulations and replace it with a new *Example 10*, properly applying §1.1502–13 of the consolidated return regulations.

In addition, the IRS and Treasury Department discovered a problem concerning the section 199 closing of the books method under §1.199–7(f)(1)(ii) of the final regulations. A corporation that becomes or ceases to be a member of an EAG during its taxable year must allocate its taxable income or loss, QPAI, and W-2 wages between the portion of the taxable year that it is a member of the EAG and the portion of the taxable year that it is not a member of the EAG. In general, this allocation is made by using the *pro rata* allocation method described in §1.199–7(f)(1)(i) of the final regulations. Section 1.199–7(f)(1)(ii) provides that in lieu of the *pro rata* allocation method, a corporation may elect to apply the section 199 closing of the books method under which a corporation treats its taxable year as two separate taxable years, the first of which ends at the close of the day on which the corporation's status as a member of the EAG changes and the second of which begins at the beginning of the day after the corporation's status as a member of the EAG changes.

In certain situations, the section 199 closing of the books method can create a larger section 199 deduction than is warranted. The facts of the *Example* in §1.199–7(g)(3) of the final regulations demonstrate such a situation. In the *Example*, Corporations X and Y, calendar year corporations, are members of the same EAG for the entire 2007 taxable year. Corporation Z, also a calendar year corporation, is a member of the EAG of which X and Y are members for the first half of 2007 and not a member of any EAG for the second half of 2007. During the 2007 taxable year, Z does not join in the filing of a consolidated return. Z makes a section 199 closing of the books election. As a result, Z has $80 of taxable income and $100 of QPAI that is allocated to the first half of 2007 and a $150 taxable loss and ($200) of QPAI that is allocated to the second half of 2007. In addition to the facts presented in the *Example*, assume that X and Y each have $60 of taxable income and QPAI in 2007, Z has $170 of taxable income and QPAI in 2008, and that X, Y, and Z each have W-2 wages in excess of the section 199(b) wage limitation for all relevant periods. After applying the section 199 closing of the books method, the EAG has $200 of taxable income and $220 of QPAI in 2007. Accordingly, the EAG will have a section 199 deduction of $12 (6 percent of the lesser of the EAG's $200 of taxable income and $220 of QPAI). Z, as a stand-alone corporation for the second half of 2007, will have both negative taxable income and negative QPAI and therefore will have no section 199 deduction. In 2008, notwithstanding that Z made a section 199 closing of the books election pursuant to which Z is deemed to have a $150 taxable loss for the second half of 2007, for purposes of computing its taxable income in 2008, Z only has a $70 NOL carryover from 2007. Accordingly, Z will have taxable income of $100 in 2008 and will have a section 199 deduction of $6 (6 percent of the lesser of its $100 of taxable income and $170 of QPAI). Because X and Y had a total of $120 of taxable income and Z had total taxable income in 2007 and 2008 of $100, the maximum aggregate section 199 deduction should have been $13.20 (6 percent of the aggregate taxable income of X, Y, and Z of $220), instead of the aggregate $18 deduction derived in the above example because of the use of the section 199 closing of the books method. The section 199 closing of the books method effectively eliminated $80 of Z's losses from being used to offset taxable income for purposes of the section 199 deduction in either 2007 or 2008.

The proposed regulations remove the section 199 closing of the books method and revise the *Example* in §1.199–7(g)(3) to apply the *pro rata* allocation method. However, the IRS and Treasury Department invite comments concerning the necessity for a section 199 closing of the books method and suggestions under which a section 199 closing of the books election would be allowable, provided that the election does not create an unwarranted section 199 deduction nor does it impose an undue burden on either taxpayers or the government.

Proposed Effective Date

Sections 1.199–3(k), 1.199–7(e), *Example 10*, and 1.199–7(f)(1) are proposed to be applicable to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on §1.199–3(k) and §1.199–7(e), *Example 10*, of the proposed regulations for taxable years beginning after December 31, 2004. However, for taxable years beginning before June 1, 2006, a taxpayer may rely on §1.199–3(k) of the proposed regulations only if the taxpayer does not apply Notice 2005–14, 2005–1 C.B. 498 (see §601.601(d)(2)(ii)(*b*)) or REG–105847–05, 2005–2 C.B. 987 (see §601.601(d)(2)) to the taxable year.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 2, 2007, at 10 a.m. in the audi-

torium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 30 minutes before the hearing starts. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments by September 5, 2007, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 11, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Lauren Ross Taylor and David M. McDonnell, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.199–3 also issued under 26 U.S.C. 199(d). * * *

Section 1.199–7 also issued under 26 U.S.C. 199(d). * * *

Section 1.199–8 also issued under 26 U.S.C. 199(d). * * *

Par. 2. Section 1.199–3 is amended by:

1. Revising paragraphs (k)(1), (k)(4), and (k)(5).
2. Redesignating paragraph (k)(6) as (k)(9).
3. Redesignating paragraph (k)(7) as (k)(10).
4. Adding new paragraphs (k)(6), (k)(7), and (k)(8).
5. Revising *Example 6* of newly designated paragraph (k)(10).

The revisions and additions read as follows:

§1.199–3 Domestic production gross receipts.

* * * * *

(k) * * *

(1) *In general*. The term *qualified film* means any motion picture film or video tape under section 168(f)(3), or live or delayed television programming (film), if not less than 50 percent of the total compensation relating to the production of such film is compensation for services performed in the United States by actors, production personnel, directors, and producers. For purposes of this paragraph (k), the term *actors* includes players, newscasters, or any other persons who are compensated for their performance or appearance in a film. For purposes of this paragraph (k), the term *production personnel* includes writers, choreographers and composers who are compensated for providing services during the production of a film, as well as casting agents, camera operators, set designers, lighting technicians, make-up artists, and other persons who are compensated for providing services that are directly related to the production of the film. Except as provided in paragraph (k)(2) of this section, the definition of a qualified film does not include tangible personal property embodying the qualified film, such as DVDs or videocassettes.

* * * * *

(4) *Compensation for services*. For purposes of this paragraph (k), the term *compensation for services* means all payments for services performed by actors, production personnel, directors, and producers relating to the production of the film, including participations and residuals. Payments for services include all elements of compensation as provided for in §1.263A–1(e)(2)(i)(B) and (3)(ii)(D). Compensation for services is not limited to W-2 wages and includes compensation paid to independent contractors. In the case of a taxpayer that uses the income forecast method of section 167(g) and capitalizes participations and residuals into the adjusted basis of the qualified film, the taxpayer must use the same estimate of participations and residuals in determining compensation for services. In the case of a taxpayer that excludes participations and residuals from the adjusted basis of the qualified film under section 167(g)(7)(D)(i), the taxpayer must use the amount expected to be paid as participations and residuals based on the total forecasted income used in determining income forecast depreciation in determining compensation for services.

(5) *Determination of 50 percent*. The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(1) of this section is calculated using a fraction. The numerator of the fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. A taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, including all historic information available, to determine the compensation for services performed in the United States and the total compensation for services regardless of where the production activities are performed. Among the factors to be considered in determining whether a taxpayer's method of allocating compensation is reasonable is whether the taxpayer uses that method consistently from one taxable year to another.

(6) *Produced by the taxpayer*. A qualified film will be treated as produced by the taxpayer for purposes of section 199(c)(4)(A)(i)(II) if the production activity performed by the taxpayer is substantial in nature within the meaning of paragraph (g)(2) of this section. The special rules of paragraph (g)(4) of this section regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer's production activity is substantial in nature. Paragraphs (g)(2) and (4) of this section are applied by substi-

tuting the term *qualified film* for QPP and disregarding the requirement that the production activity must be within the United States. The production activity of the taxpayer must consist of more than the minor or immaterial combination or assembly of two or more components of a film. For purposes of paragraph (g)(2) of this section, the relative value added by affixing trademarks or trade names as defined in §1.197–2(b)(10)(i) will be treated as zero.

(7) *Qualified film produced by the taxpayer — safe harbor.* A film will be treated as a qualified film under paragraph (k)(1) of this section and produced by the taxpayer under paragraph (k)(6) of this section (qualified film produced by the taxpayer) if the taxpayer meets the requirements of paragraphs (k)(7)(i) and (ii) of this section. A taxpayer that chooses to use this safe harbor must apply all the provisions of this paragraph (k)(7).

(i) *Safe harbor.* A film will be treated as a qualified film produced by the taxpayer if not less than 50 percent of the total compensation for services paid by the taxpayer is compensation for services performed in the United States and the taxpayer satisfies the safe harbor in paragraph (g)(3) of this section. The special rules of paragraph (g)(4) of this section regarding a contract with an unrelated person and aggregation apply in determining whether the taxpayer satisfies paragraph (g)(3) of this section. Paragraphs (g)(3) and (4) of this section are applied by substituting the term *qualified film* for QPP but not disregarding the requirement that the direct labor and overhead of the taxpayer to produce the qualified film must be within the United States. Paragraph (g)(4)(ii)(A) of this section includes any election under section 181.

(ii) *Determination of 50 percent.* The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(7)(i) of this section is calculated using a fraction. The numerator of the fraction is the compensation for services paid by the taxpayer for services performed in the United States and the denominator is the total compensation for services paid by the taxpayer regardless of where the production activities are performed. For purposes of this paragraph (k)(7)(ii), the term *paid by the taxpayer* includes amounts that are treated as paid by the taxpayer under paragraph (g)(4) of this section. A taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, including all historic information available, to determine the compensation for services paid by the taxpayer for services performed in the United States and the total compensation for services paid by the taxpayer regardless of where the production activities are performed. Among the factors to be considered in determining whether a taxpayer's method of allocating compensation is reasonable is whether the taxpayer uses that method consistently from one taxable year to another.

(8) *Production pursuant to a contract.* With the exception of the rules applicable to an expanded affiliated group (EAG) under §1.199–7 and EAG partnerships under §1.199–3T(i)(8), only one taxpayer may claim the deduction under §1.199–1(a) with respect to any activity related to the production of a qualified film performed in connection with the same qualified film. If one taxpayer performs a production activity pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the qualified film under Federal income tax principles during the period in which the production activity occurs is treated as engaging in the production activity.

* * * * *

(10) * * *

Example 6. X creates a television program in the United States that includes scenes from films licensed by X from unrelated persons Y and Z. Assume that Y and Z produced the films licensed by X. The not-less-than-50-percent-of-the-total-compensation requirement under paragraph (k)(1) of this section is determined by reference to all compensation for services paid in the production of the television program, including the films licensed by X from Y and Z, and is calculated using a fraction as described in paragraph (k)(5) of this section. The numerator of the fraction is the compensation for services performed in the United States and the denominator is the total compensation for services regardless of where the production activities are performed. However, for purposes of calculating the denominator, in determining the total compensation paid by Y and Z, X need only include the total compensation paid by Y and Z to actors, production personnel, directors, and producers for the production of the scenes used by X in creating its television program.

Par. 3. Section 1.199–7 is amended by:

1. Revising *Example 10* of paragraph (e).

2. Revising paragraphs (f)(1) and (g)(3).

The revisions read as follows:

§1.199–7 Expanded affiliated groups.

* * * * *

(e) * * *

Example 10. (i) *Facts.* Corporation P owns all of the stock of Corporations S and B. P, S, and B file a consolidated Federal income tax return on a calendar year basis. P, S, and B each use the section 861 method for allocating and apportioning their deductions. In 2010, S MPGE QPP in the United States at a cost of $1,000. On November 30, 2010, S sells the QPP to B for $2,500. On February 28, 2011, P sells 60% of the stock of B to X, an unrelated person. On June 30, 2011, B sells the QPP to U, another unrelated person, for $3,000.

(ii) *Consolidated group's 2010 QPAI.* Because S and B are members of a consolidated group in 2010, pursuant to §1.199–7(d)(1) and §1.1502–13, neither S's $1,500 of gain on the sale of QPP to B nor S's $2,500 gross receipts from the sale are taken into account in 2010. Accordingly, neither S nor B has QPAI in 2010.

(iii) *Consolidated group's 2011 QPAI.* B becomes a nonmember of the consolidated group at the end of the day on February 28, 2011, the date on which P sells 60% of the B stock to X. Under §1.199–7(d)(1) and §1.1502–13(d), S takes the intercompany transaction into account immediately before B becomes a non-member of the consolidated group. Pursuant to §1.1502–13(d)(1)(ii)(A)(*1*), because the QPP is owned by B, a nonmember of the consolidated group immediately after S's gain is taken into account, B is treated as selling the QPP to a nonmember for $2,500, B's adjusted basis in the property, immediately before B becomes a nonmember of the consolidated group. Accordingly, immediately before B becomes a nonmember of the consolidated group, S takes into account $1,500 of QPAI (S's $2,500 DPGR received from B - S's $1,000 cost of MPGE the QPP).

(iv) *B's 2011 QPAI.* Pursuant to §1.1502–13(d)(2)(i)(B), the attributes of B's corresponding item, that is, its sale of the QPP to U, are determined as if the S division (but not the B division) were transferred by the P, S, and B consolidated group (treated as a single corporation) to an unrelated person. Thus, S's activities in MPGE the QPP before the intercompany sale of the QPP to B continue to affect the attributes of B's sale of the QPP. As such, B is treated as having MPGE the QPP. Accordingly, upon its sale of the QPP, B has $500 of QPAI (B's $3,000 DPGR received from U - B's $2,500 cost of MPGE the QPP).

* * * * *

(f) *Allocation of income and loss by a corporation that is a member of the expanded affiliated group for only a portion of the year*—(1) *In general.* A corporation that becomes or ceases to be a member of an EAG during its taxable year must allocate its taxable income or loss, QPAI, and W-2 wages between the portion of the taxable year that it is a member of the EAG and the portion of the taxable year that it is not a member of the EAG. This allocation of items is made by using the *pro rata*

allocation method described in this paragraph (f)(1). Under the *pro rata* allocation method, an equal portion of a corporation's taxable income or loss, QPAI, and W-2 wages for the taxable year is assigned to each day of the corporation's taxable year. Those items assigned to those days that the corporation was a member of the EAG are then aggregated.

* * * * *

(g) * * *

(3) *Example.* The following example illustrates the application of paragraphs (f) and (g) of this section:

Example. (i) *Facts.* Corporations X and Y, calendar year corporations, are members of the same EAG for the entire 2010 taxable year. Corporation Z, also a calendar year corporation, is a member of the EAG of which X and Y are members for the first half of 2010 and not a member of any EAG for the second half of 2010. During the 2010 taxable year, neither X, Y, nor Z join in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each have W-2 wages in excess of the section 199(b) wage limitation for all relevant periods. In 2010, X has taxable income of $2,000 and QPAI of $600, Y has a taxable loss of $400 and QPAI of ($200), and Z has taxable income of $1,400 and QPAI of $2,400.

(ii) *Analysis.* Pursuant to the *pro rata* allocation method, $700 of Z's 2010 taxable income and $1,200 of Z's 2010 QPAI are allocated to the first half of the 2010 taxable year (the period in which Z is a member of the EAG) and $700 of Z's 2010 taxable income and $1,200 of Z's 2010 QPAI are allocated to the second half of the 2010 taxable year (the period in which Z is not a member of any EAG). Accordingly, in 2010, the EAG has taxable income of $2,300 (X's $2,000 + Y's ($400) + Z's $700) and QPAI of $1,600 (X's $600 + Y's ($200) + Z's $1,200). The EAG's section 199 deduction for 2010 is therefore $144 (9% of the lesser of the EAG's $2,300 of taxable income or $1,600 of QPAI). Pursuant to §1.199–7(c)(1), this $144 deduction is allocated to X, Y, and Z in proportion to their respective QPAI. Accordingly, X is allocated $48 of the EAG's section 199 deduction, Y is allocated $0 of the EAG's section 199 deduction, and Z is allocated $96 of the deduction. For the second half of 2010, Z has taxable income of $700 and QPAI of $1,200. Therefore, for the second half of 2010, Z has a section 199 deduction of $63 (9% of the lesser of its $700 taxable income or $1,200 QPAI for the second half of 2010). Accordingly, X's 2010 section 199 deduction is $48, Y's 2010 section 199 deduction is $0, and Z's 2010 section 199 deduction is $159, the sum of the $96 section 199 deduction of the EAG allocated to Z for the first half of 2010 and Z's $63 section 199 deduction for the second half of 2010.

Par. 4. Section 1.199–8 is amended by:

1. Adding two sentences at the end of paragraph (a).

2. Adding new paragraphs (i)(8) and (i)(9).

The revisions and additions read as follows:

§1.199–8 Other rules.

(a) * * * For purposes of §§1.199–1 through 1.199–9, use of terms such as *payment, paid, incurred,* or *paid or incurred* is not intended to provide any specific rule based upon the use of one term versus another. In general, the use of the term *payment, paid, incurred,* or *paid or incurred* is intended to convey the appropriate standard under the taxpayer's method of accounting.

* * * * *

(i) * * *

(8) *Qualified film produced by the taxpayer.* Section 1.199–3(k) is proposed to be applicable to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on §1.199–3(k) of these proposed regulations for taxable years beginning after December 31, 2004. However, for taxable years beginning before June 1, 2006, a taxpayer may rely on §1.199–3(k) of the proposed regulations only if the taxpayer does not apply Notice 2005–14, 2005–1 C.B. 498 (see §601.601(d)(2)(ii)(*b*) of this chapter), or REG–105847–05, 2005–2 C.B. 987 (see §601.601(d)(2)(ii)(*b*) of this chapter), to the taxable year.

(9) *Expanded affiliated groups.* Section 1.199–7(e), *Example 10,* and §1.199–7(f)(1) are proposed to be applicable to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on §1.199–7(e), *Example 10,* of these proposed regulations for taxable years beginning after December 31, 2004.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 7, 2007, 72 F.R. 31478)

Closing of the GUST Program for Pre-Approved Defined Benefit Plans

Announcement 2007–61

On September 7, 2007, the Service will discontinue accepting applications for opinion and advisory letters for pre-approved (*i.e.*, master and prototype (M&P) and volume submitter (VS)) defined benefit plans that have not been restated to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16, ("EGTRRA") and other changes in plan qualification requirements listed in Notice 2007–3, 2007–2 I.R.B. 254 ("the 2006 Cumulative List"). The Service is taking this action because the timely submission period for the initial (EGTRRA) six-year amendment/approval cycle for pre-approved defined benefit plans described in Rev. Proc. 2007–44, page 54, this Bulletin, is now open.

Rev. Proc. 2007–44 and Rev. Proc. 2005–16, 2005–1 C.B. 674, describe a staggered remedial amendment system for plans that are qualified under § 401(a) of the Internal Revenue Code, with five-year amendment/approval cycles for individually designed plans and six-year cycles for pre-approved plans. The submission period for the initial cycle for pre-approved defined benefit plans started on February 1, 2007 and runs through January 31, 2008. Sponsors and practitioners are required to restate their pre-approved defined benefit plans for EGTRRA and the 2006 Cumulative List and apply for new opinion or advisory letters during this submission period.

Applications for opinion/advisory letters for pre-approved defined benefit plans that were filed before February 1, 2007 will be reviewed by the Service for com-

pliance with GUST[1] and letters for these plans will not consider EGTRRA or subsequent changes in the plan qualification requirements. Applications filed on or after February 1, 2007 and before September 7, 2007, will also be reviewed only for GUST unless the plan submitted with the application was restated to comply with EGTRRA and the 2006 Cumulative List.

Because the plans described in the preceding paragraph must be restated for EGTRRA and resubmitted to the Service during the current submission period, sponsors and practitioners may wish to withdraw applications for such plans that are currently pending with the Service. In this case, the user fee paid with the application will not be refunded, but the user fee requirement will be waived for a new application for the same plan that is filed within the submission period. The sponsor or practitioner should indicate on the face of the application form that the user fee is being waived pursuant to Announcement 2007–61.

Applications for opinion/advisory letters for pre-approved defined benefit plans that are filed on or after September 7, 2007, will be returned if the plan has not been restated for EGTRRA and the 2006 Cumulative List.

This announcement does not affect the ability of employers to apply for individual determination letters. Thus, the Service will continue to accept applications for determination letters on Form 5307, *Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans*, which are filed by adopters of both defined contribution and defined benefit pre-approved plans.

[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 167.—Depreciation

A revenue procedure provides a safe harbor method of accounting to treat rotable spare parts as depreciable assets in accordance with Rev. Rul. 2003–37, 2003–1 C.B. 717, and allows taxpayers to obtain the automatic consent of the Commissioner to change to the safe harbor method of accounting. See Rev. Proc. 2007-48, page 110.

Section 168.—Accelerated Cost Recovery System

A revenue procedure provides a safe harbor method of accounting to treat rotable spare parts as depreciable assets in accordance with Rev. Rul. 2003–37, 2003–1 C.B. 717, and allows taxpayers to obtain the automatic consent of the Commissioner to change to the safe harbor method of accounting. See Rev. Proc. 2007-48, page 110.

Section 170.—Charitable, etc., Contributions and Gifts

26 CFR 1.170A–6: Charitable contribution in trust.

Sample inter vivos charitable lead annuity trusts. This revenue procedure contains sample declarations of trust for nongrantor and grantor charitable lead annuity trusts. This revenue procedure also contains annotations to the sample trusts and alternate provisions that may be integrated into the sample trusts. See Rev. Proc. 2007-45, page 89.

Section 446.—General Rule for Methods of Accounting

A revenue procedure provides a safe harbor method of accounting to treat rotable spare parts as depreciable assets in accordance with Rev. Rul. 2003–37, 2003–1 C.B. 717, and allows taxpayers to obtain the automatic consent of the Commissioner to change to the safe harbor method of accounting. See Rev. Proc. 2007-48, page 110.

Section 481.—Adjustments Required by Changes in Method of Accounting

A revenue procedure provides a safe harbor method of accounting to treat rotable spare parts as depreciable assets in accordance with Rev. Rul. 2003–37, 2003–1 C.B. 717, and allows taxpayers to obtain the automatic consent of the Commissioner to change to the safe harbor method of accounting. See Rev. Proc. 2007-48, page 110.

Section 642.—Special Rules for Credits and Deductions

26 CFR 1.642(c)–1: Unlimited deduction for amounts paid for a charitable purpose.

Sample inter vivos charitable lead annuity trusts. This revenue procedure contains sample declarations of trust for nongrantor and grantor charitable lead annuity trusts. This revenue procedure also contains annotations to the sample trusts and alternate provisions that may be integrated into the sample trusts. See Rev. Proc. 2007-45, page 89.

26 CFR 1.642(c)–1: Unlimited deduction for amounts paid for a charitable purpose.

Sample testamentary charitable lead annuity trust. This revenue procedure contains a sample declaration of trust for a testamentary charitable lead annuity trust. This revenue procedure also contains annotations to the sample trust and alternate provisions that may be integrated into the sample trust. See Rev. Proc. 2007-46, page 102.

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055–2: Transfers not exclusively for charitable purposes.

Sample inter vivos charitable lead annuity trusts. This revenue procedure contains sample declarations of trust for nongrantor and grantor charitable lead annuity trusts. This revenue procedure also contains annotations to the sample trusts and alternate provisions that may be integrated into the sample trusts. See Rev. Proc. 2007-45, page 89.

26 CFR 20.2055–2: Transfers not exclusively for charitable purposes.

Sample testamentary charitable lead annuity trust. This revenue procedure contains a sample declaration of trust for a testamentary charitable lead annuity trust. This revenue procedure also contains annotations to the sample trust and alternate provisions that may be integrated into the sample trust. See Rev. Proc. 2007-46, page 102.

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(c)–3: Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

Sample inter vivos charitable lead annuity trusts. This revenue procedure contains sample declarations of trust for nongrantor and grantor charitable lead annuity trusts. This revenue procedure also contains annotations to the sample trusts and alternate provisions that may be integrated into the sample trusts. See Rev. Proc. 2007-45, page 89.

Part III. Administrative, Procedural, and Miscellaneous

Loss Importation Transaction

Notice 2007–57

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which a U.S. taxpayer uses offsetting positions with respect to foreign currency or other property for the purpose of importing a loss, but not the corresponding gain, in determining U.S. taxable income. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

In one variation of the loss importation transaction, a U.S. taxpayer (Taxpayer) is a shareholder of an S corporation (S Corporation). S Corporation acquires control of a foreign entity (Foreign Entity) by purchasing from a foreign shareholder stock of Foreign Entity meeting the requirements of § 1504(a)(2). When S Corporation purchases the Foreign Entity stock, Foreign Entity is classified as a corporation for U.S. tax purposes under § 301.7701–2(b)(2) and § 301.7701–3(b)(2)(i)(B) of the Procedure and Administration Regulations, and is a controlled foreign corporation (CFC) within the meaning of § 957(a).

Foreign Entity enters into substantially offsetting positions in foreign currency. Next, Foreign Entity disposes of or closes out some positions in the foreign currency for a gain while retaining the offsetting loss positions. Foreign Entity is not itself subject to U.S. taxation on the gains from the offsetting options. Foreign Entity may use the proceeds from these dispositions or closings out to enter into new positions in foreign currency. By entering into the new positions in foreign currency, Foreign Entity can effectively preserve the retained loss positions in the foreign currency and virtually eliminate further economic risk.

After realizing gains from disposing of or closing out some of the offsetting positions, Foreign Entity elects to be disregarded as an entity separate from its owner for U.S. tax purposes. Based on the effective date of this election, Foreign Entity is not a CFC for an uninterrupted period of 30 days during Foreign Entity's taxable year, and S Corporation is not required to include any of Foreign Entity's subpart F income in its gross income. See § 951(a). The gains are not otherwise subject to U.S. taxation. See, *e.g.*, §§ 881 and 882. The election results in the distribution of all of Foreign Entity's assets and liabilities to its shareholder in a deemed liquidation of Foreign Entity. See Treas. Reg. § 301.7701–3(g)(1)(iii). After the election, some or all of the loss positions in the foreign currency are allowed to expire, are disposed of, or are closed out, and some or all of the gain positions are allowed to expire, are disposed of, or are closed out, resulting in an aggregate net loss. S Corporation passes Taxpayer's *pro rata* share of the loss through to Taxpayer. Taxpayer purports to have sufficient basis in its S Corporation stock or in its indebtedness to S Corporation to enable Taxpayer to claim the loss.

Variations exist in the types of entities and forms of loss importation used in the transaction described above. For example, in one variation of the transaction, a C corporation may be used instead of an S corporation; or a foreign entity with more than one owner may elect to be classified for U.S. tax purposes as a partnership, rather than as an entity disregarded as separate from its owner. Further, the importation of the loss may be accomplished by other methods, such as a corporate reorganization described in § 368(a) or a transfer to which § 351 applies. Variations also exist in how the offsetting positions may be used in the transaction described above. For example, taxpayers may use positions with respect to property other than foreign currency.

DISCUSSION

The transactions described in this notice are designed so that taxpayers may claim losses without taking into account the corresponding gains attributable to the offsetting positions in foreign currency or other property. In the loss importation transaction described above, taxpayers are attempting to exploit the entity classification rules and § 951(a) in order to claim losses without taking into account the corresponding gains attributable to the offsetting positions in foreign currency. The Service may challenge these transactions by, for example, disallowing the loss or allocating the loss to the CFC. The Service may assert one or a combination of arguments including, but not limited to, arguments under §§ 165, 269, 482, and 988. In addition, the Service may assert that the transaction fails one or more judicial doctrines, such as the economic substance doctrine.

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of §§ 1.6011–4(b)(2) and §§ 6111 and 6112 effective June 20, 2007, the date this notice was released to the public. Independent of their classification as listed transactions, transactions that are the same as, or substantially similar to, the transactions described in this notice may already be subject to the requirements of § 6011, § 6111, § 6112, or the regulations thereunder.

Persons required to disclose these transactions under § 1.6011–4 who fail to do so may be subject to the penalty under § 6707A which applies to returns and statements due after October 22, 2004. Persons required to disclose these transactions under § 1.6011–4 who fail to do so may be subject to an extended period of limitations under § 6501(c)(10). Persons required to disclose or register these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on persons involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or § 6662A.

The Service and Treasury recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the type of transactions described in this notice. These taxpayers should take appropriate corrective action and ensure that their transactions are disclosed properly.

DRAFTING INFORMATION

The principal author of this notice is Megan Stoner of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Stoner at (202) 622–3070 (not a toll-free call).

Request for Comments Regarding Financial Services Income Under Section 904(d)

Notice 2007–58

The Internal Revenue Service (IRS) and the Treasury Department are studying the appropriateness of updating Treasury Regulation § 1.904–4(e) in light of recent statutory changes. This notice invites public comments relating to the definitions of financial services income, active financing income or financial services entities under that regulation.

BACKGROUND

Section 404 of the American Jobs Creation Act of 2004, Public Law 108–357, 118 Stat. 1418 (October 22, 2004) (AJCA) generally reduced the number of separate foreign tax credit limitation categories under section 904(d) of the Internal Revenue Code (the Code) from eight to two, effective for taxable years beginning after December 31, 2006. As a result, income which would have been assigned to the separate category for financial services income had such income been earned in a taxable year beginning before January 1, 2007, is now treated as general category income. However, this applies only in the case of a member of a financial services group or any other person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. Section 904(d)(2)(C)(i). Treasury Regulation § 1.904–4(e)(3)(i) currently provides that a person is considered to be predominantly engaged in the active financing business for any year if for that year at least 80 percent of its gross income is active financing income, as defined in Treasury Regulation § 1.904–4(e)(2).

Section 401 of the AJCA modifies present-law interest expense allocation rules under section 864 of the Code to provide taxpayers with a one-time election under new section 864(f) to allocate and apportion interest expense of the domestic members of a worldwide affiliated group (as defined in new section 864(f)(1)(C)) on a worldwide-group basis. Taxpayers are allowed to apply present-law financial institution group rules to treat certain financial institutions as a separate affiliated group for purposes of interest allocation under the worldwide fungibility approach. In the alternative, section 401 of the AJCA also provides a one-time election under section 864(f)(5) to expand the present-law financial institution group to include "financial corporations." A financial corporation, as defined in new section 864(f)(5)(B), is any corporation if at least 80 percent of its gross income is financial services income, as described in section 904(d)(2)(D)(ii) of the Code and the regulations thereunder, derived from transactions with persons who are not related (within the meaning of section 267(b) or 707(b)(1)) to the corporation. This provision is effective for taxable years beginning after December 31, 2008.

The IRS and the Treasury Department believe that it is appropriate to review the provisions relating to financial services income and entities in Treasury Regulation § 1.904–4(e) in light of the amendments to the foreign tax credit rules in the AJCA.

REQUEST FOR COMMENTS

The IRS and the Treasury Department request comments specifically on whether any items currently listed as active financing income under Treasury Regulation § 1.904–4(e)(2)(i) are over-inclusive or under-inclusive and whether any of the listed items should be clarified as applying only to transactions involving customers. More generally, comments are welcome as to whether any other provisions of Treasury Regulation § 1.904–4(e) relating to the definitions of financial services income, active financing income or financial services entities should be modified to take into consideration recent statutory changes or any changes in the nature of financial services that have taken place since this regulation was originally published.

Comments should be submitted on or before September 10, 2007, and should include a reference to Notice 2007–58. Send submissions to CC:PA:LPD:PR (Notice 2007–58), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered **Monday through Friday** between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2007–58), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the following e-mail address: *Notice.comments@irscounsel.treas.gov*. Please include "Notice 2007–58" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this announcement is Jeffrey L. Parry of the Office of Associate Chief Counsel (International). For further information regarding this announcement, contact Jeffrey L. Parry at (202) 622–3850 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters.
(Also: Part I, §§ 170, 642(c), 2055, 2522; §§ 1.170A–6, 20.2055–2, 25.2522(c)–3.)

Rev. Proc. 2007–45

SECTION 1. PURPOSE

This revenue procedure contains annotated sample declarations of trust and alternate provisions that meet the requirements for an inter vivos charitable lead annuity trust (CLAT) providing for annuity payments payable to one or more charitable beneficiaries for the annuity period followed by the distribution of trust assets to one or more noncharitable remaindermen.

SECTION 2. BACKGROUND

The Internal Revenue Service (Service) is issuing sample forms for CLATs; annotations and alternate sample provisions are included as further guidance. In addition to the sample trust instruments for inter vivos CLATs that are included in this revenue procedure, a sample is provided in a separate revenue procedure for a testamentary CLAT (see Rev. Proc. 2007–46, 2007–29 I.R.B. 102).

SECTION 3. SCOPE

A CLAT is an irrevocable split-interest trust that provides for a specified amount to be paid to one or more charitable beneficiaries during the term of the trust. The principal remaining in the trust at the end of the term is paid over to, or held in a continuing trust for, a noncharitable beneficiary or beneficiaries identified in the trust. If the terms of a CLAT created during the donor's life satisfy the applicable statutory and regulatory requirements, a gift of the charitable lead annuity interest will qualify for the gift tax charitable deduction under § 2522(c)(2)(B) and/or the estate tax charitable deduction under § 2055(e)(2)(B). In certain cases, the gift of the annuity interest may also qualify for the income tax charitable deduction under § 170(a). The value of the remainder interest is a taxable gift by the donor at the time of the donor's contribution to the trust.

There are two types of inter vivos CLATs: a "nongrantor CLAT" and a "grantor CLAT." The income tax consequences are different for each.

A nongrantor CLAT is subject to the provisions of part I, subchapter J of chapter 1 of subtitle A of the Internal Revenue Code (Code). Under the provisions of part I of subchapter J, a nongrantor CLAT is allowed a deduction under § 642(c)(1) in determining its taxable income for any amount of gross income paid for purposes specified in § 170(c). Generally, the donor is not entitled to any income tax charitable deduction.

Section 4 of this revenue procedure provides a sample declaration of trust for a nongrantor CLAT with a term of years annuity period that is created by an individual who is a citizen or resident of the United States. Section 5 of this revenue procedure provides annotations to the provisions of the sample trust. Section 6 of this revenue procedure provides samples of certain alternate provisions concerning: (.01) an annuity period for the life of an individual; (.02) retention of the right to substitute the charitable lead beneficiary; (.03) apportionment of the annuity amount in the discretion of the trustee; (.04) the annuity amount as a specific dollar amount; and (.05) designation of an alternate charitable beneficiary in the trust instrument. If a trust is substantially similar to the sample trust in section 4 of this revenue procedure or properly integrates one or more alternate provisions from section 6 into a document substantially similar to the sample trust in section 4, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other deductibility requirements are satisfied, the value of the charitable lead interest will be deductible under § 2522(c)(2)(B) and/or § 2055(e)(2)(B) and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by § 642(c)(1). In addition, a nongrantor CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust and/or provides for a different disposition of trust assets upon the termination of the annuity period.

A CLAT is a grantor CLAT if the donor, who is a citizen or resident of the United States, is treated as the owner of the entire CLAT under subpart E, part I of subchapter J, chapter 1, subtitle A. The value of the charitable lead annuity interest in a grantor CLAT may be deductible by the donor under § 170(a) for the year in which the donor made the contribution to the trust, provided that the other requirements of § 170(f)(2)(B) and the regulations thereunder are satisfied. During the term of the grantor CLAT, all trust income and capital gains are taxed to the donor and the donor is entitled to no further charitable deduction for income tax purposes as the charitable annuity payments are made to charitable organizations each year.

Section 7 of this revenue procedure provides a sample declaration of trust for a grantor CLAT that is created by an individual who is a citizen or resident of the United States. Section 8 of this revenue procedure provides annotations to the provisions of the sample trust. Section 9 of this revenue procedure provides samples of certain alternate provisions concerning: (.01) an annuity period for the life of an individual; (.02) retention of the right to substitute the charitable lead beneficiary; (.03) apportionment of the annuity amount in the discretion of the trustee; (.04) the annuity amount as a specific dollar amount; (.05) designation of an alternate charitable beneficiary in the trust instrument; and (.06) restriction of the charitable beneficiary to a public charity. If a trust is substantially similar

to the sample trust in section 7 of this revenue procedure or properly integrates one or more alternate provisions from section 9 into a document substantially similar to the sample trust in section 7, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other requirements for deductibility are satisfied, the value of the charitable lead annuity interest will be deductible under §§ 170(a), 2522(c)(2)(B) and/or 2055(e)(2)(B). In addition, a grantor CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it: (i) reflects the choice of a different power or provision sufficient to make the donor the owner of the entire CLAT under subpart E, part I, subchapter J, chapter 1, subtitle A, provided that the power or provision selected is consistent with the requirements of a CLAT; (ii) defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust; and/or (iii) provides for a different disposition of trust assets upon the termination of the annuity period.

Except as provided above, a trust that contains substantive provisions in addition to those provided in section 4 or section 7 of this revenue procedure (other than properly integrated alternate provisions from section 6 or section 9, respectively, of this revenue procedure or provisions necessary to establish a valid trust under applicable local law that are not inconsistent with the applicable federal tax requirements), or that omits any of the provisions of section 4 or section 7 of this revenue procedure (unless an alternate provision from section 6 or section 9, respectively, of this revenue procedure is properly integrated), will not necessarily be ineligible for the relevant charitable deduction(s), but neither will that trust (or contributions to it) be assured of qualification for the appropriate charitable deductions. The Service generally will not issue a letter ruling on whether an inter vivos CLAT created by an individual qualifies for income, estate, and/or gift tax charitable deductions. The Service, however, generally will issue letter rulings relating to the tax consequences of the inclusion in a CLAT of substantive trust provisions other than those contained in sections 4, 6, 7, and 9 of this revenue procedure.

SECTION 4. SAMPLE INTER VIVOS NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

On this ________ day of ______________, 20____, I, ______________ (hereinafter "the Donor"), desiring to establish a charitable lead annuity trust within the meaning of Rev. Proc. 2007–45, hereby enter into this trust agreement with ______________ as the initial trustee (hereinafter "the Trustee"). This trust shall be known as the ______________ Nongrantor Charitable Lead Annuity Trust. All references to "section" or "§" in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, *et seq.*

1. *Funding of Trust.* The Donor hereby transfers and irrevocably assigns to the Trustee on the above date the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage, and distribute the property under the terms set forth in this trust instrument.

2. *Payment of Annuity Amount.* In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*number representing the annual annuity percentage to be paid to the designated charitable recipient*] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. If [*designated charitable recipient*] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [*number of years of annuity period*] years. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the day preceding the [*ordinal number corresponding to the length of the annuity period*] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. *Proration of Annuity Amount.* The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year in which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. *Distribution Upon Termination of Annuity Period.* At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due to the Charitable Organization under the provisions above) to [*remainder beneficiary*].

5. *Additional Contributions.* No additional contributions shall be made to the trust after the initial contribution.

6. *Prohibited Transactions.* The Trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The Trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3). In addition, the Trustee shall not acquire any assets that would subject the trust to tax under § 4944, as modified by

§§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

7. *Taxable Year*. The taxable year of the trust shall be the calendar year.

8. *Governing Law*. The operation of the trust shall be governed by the laws of the State of ______________. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the requirements for the charitable deductions available to a charitable lead annuity trust or for contributions to a charitable lead annuity trust.

9. *Limited Power of Amendment*. This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the Charitable Organization is a guaranteed annuity interest under §§ 2055(e)(2)(B) and 2522(c)(2)(B) and the regulations thereunder and that payments of the annuity amount to the Charitable Organization will be deductible from the gross income of the trust to the extent provided by § 642(c)(1) and the regulations thereunder.

10. *Investment of Trust Assets*. Except as provided in paragraph 6 herein, nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

11. *Retained Powers and Interests*. Notwithstanding any other provision of this trust instrument to the contrary, no person shall hold any power or possess any interest that would cause the Donor to be treated as the owner of any portion of the trust under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Internal Revenue Code.

SECTION 5. ANNOTATIONS REGARDING SAMPLE INTER VIVOS NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 *Annotations for Introductory Paragraph and Paragraph 1, Funding of Trust, of the Sample Trust in Section 4.*

(1) *Types of charitable lead trusts*. An inter vivos charitable lead trust may be established as either a grantor charitable lead trust or a nongrantor charitable lead trust. The sample trust in section 4 is an example of a nongrantor charitable lead trust. The sample trust in section 7 is an example of a grantor charitable lead trust.

(2) *Income taxation of nongrantor charitable lead trusts*. A nongrantor CLAT is a complex trust that is taxable as a separate entity under the provisions of subchapter J of the Code. The trustee of the trust must apply for a tax identification number for the trust.

(3) *Deduction under § 642(c)(1) available for amounts paid for a charitable purpose*. Under § 642(c)(1), a nongrantor CLAT is allowed a deduction in computing its taxable income for any amount of gross income, without limitation, that under the terms of the trust instrument is paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)) during the taxable year. This deduction is in lieu of the charitable deduction allowed by § 170. Section 642(c)(1) and § 1.642(c)–1(a). An amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in § 170(c)(2) shall be considered paid for a purpose described in § 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any state, the District of Columbia, or any possession of the United States. Section 1.642(c)–1(a)(2). With regard to amounts of income paid to the charitable beneficiary after the close of the taxable year in which the income was received (but on or before the last day of the next succeeding taxable year), the trustee of a nongrantor CLAT may elect to take the charitable deduction for that payment for the year in which the income was received, rather than for the year in which the payment was made. Section 642(c)(1). The election is made by filing a statement with the income tax return for the taxable year in which the charitable contribution is treated as paid. See § 1.642(c)–1(b).

(4) *Charitable lead beneficiary requirements*. A deduction is allowed under § 642(c)(1) for any amount of the gross income of a nongrantor CLAT that is paid for a purpose specified in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 642(c)(1) differs from the class of permissible charitable recipients for obtaining a deduction under § 170(a). Compare § 170(c) and § 1.642(c)–1(a)(2).

(5) *Unrelated business taxable income*. Under § 681, a nongrantor charitable lead trust's deduction under § 642(c)(1) is disallowed in any year to the extent that the deduction is allocable to the trust's unrelated business taxable income, as defined in § 512, for that taxable year. See § 1.681(a)–2. However, a partial deduction is allowed under § 512(b)(11) for amounts allocable to unrelated business taxable income. Section 512(b)(11). See § 512(b)(12) and § 1.681(a)–2(a).

(6) *Computation of estate and gift tax charitable deductions*. In general, the estate and gift tax charitable deductions available under §§ 2055(e)(2)(B) and 2522(c)(2)(B) with respect to contributions to a CLAT are equal to the present value of the annuity interest. Section 7520 requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See §§ 20.7520–2 and 25.7520–2.

(7) *Trustee provisions*. The trust instrument may name alternate or successor trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain administrative provisions relating to the trustee's duties and powers.

(8) *Identity of donor.* For purposes of qualification under this revenue procedure, the donor may be an individual or a husband and wife. Appropriate adjustments should be made to the introductory paragraph if a husband and wife are the donors. Terms such as "grantor" or "settlor" may be substituted for "donor."

.02 Annotations for Paragraph 2, Payment of Annuity Amount, of the Sample Trust in Section 4.

(1) *Guaranteed annuity.* To qualify for the applicable estate and gift tax charitable deductions, a nongrantor CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See §§ 2055(e)(2)(B) and 2522(c)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 5.02(4) for a discussion of the permissible term of a nongrantor CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained at the time of the transfer to the trust. Sections 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a sum certain or a fixed percentage of the trust assets (determined annually) is not a guaranteed annuity interest. See §§ 20.2055–2(e)(2)(vi)(*b*) and 25.2522(c)–3(c)(2)(vi)(*b*). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88–27, 1988–1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the date of gift exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Sections 20.2055–2(e)(2)(vi)(*e*) and 25.2522(c)–3(c)(2)(vi)(*e*). These prohibitions are contained in the sample trust in section 4. See section 5.06 for a further discussion of the 60 percent test. See section 6.04 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

(2) *Payment requirements.* CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the trust will realize capital gain on the assets distributed to satisfy part or all of the annuity payment and the trust will be allowed a § 642(c)(1) deduction for the realized capital gains. Rev. Rul. 83–75, 1983–1 C.B. 114.

(3) *Rule against perpetuities.* An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of the measuring lives who are selected to maximize, rather than limit, the term of the trust. Sections 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*).

(4) *Permissible term.* Paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for payment of the annuity amount for the life or lives of one or more measuring lives or for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85–49, 1985–1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the date assets are transferred to the trust. Sections 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*). See section 6.01 for an alternate provision that provides for an annuity period based on the life of an individual.

(5) *Permissible recipients.* A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the donor from receiving a charitable deduction if the trust instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c), 2055(a), and 2522(a). Rev. Rul. 78–101, 1978–1 C.B. 301. If it is determined that a deduction under § 2055(a) will not be necessary in any event, all references to § 2055(a) in the trust instrument may be deleted. Note, that if the donor is serving as trustee of the trust, the trustee's power to select the charitable beneficiaries will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c). Further note that if the charitable beneficiary is a private foundation and the donor is an officer or director of the private foundation or possesses certain decision making authority in the private foundation, some or all of the trust property may be included in the donor's gross estate. See § 2036(a)(2). See section 6.02 for an alternate provision that provides for a donor's retained right to substitute the charitable beneficiary.

See section 6.03 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable beneficiaries.

(6) *Payment of annuity amount in installments.* Paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 specifies that the annuity amount is to be paid in equal quarterly installments at the end of each calendar quarter. Alternatively, the trust instrument may specify that the annuity amount is to be paid in annual or other equal or unequal installments throughout the year. See §§ 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*). The amount of the charitable deduction will be affected by the frequency of the payment, by whether the installments are equal or unequal, and by whether each installment is payable at the beginning or end of the period. See §§ 25.2512–5 and 20.2031–7.

(7) *Excess income.* Trust income in excess of the amount required to pay the annuity may be retained by the trust or distributed currently to the charitable beneficiary. The sample trust in section 4 provides for the retention of excess income by the trust. If, instead, the governing instrument of a nongrantor charitable lead trust provides for the payment of excess income to or for the use of the charitable beneficiary, no additional estate or gift tax charitable deductions are available for the excess amounts of income distributed to the charitable beneficiary. See §§ 20.2055–2(e)(2)(vi)(*d*) and 25.2522(c)–3(c)(2)(vi)(*d*). However, the trust is entitled to a charitable income tax deduction under § 642(c)(1) for any amounts of excess income paid to the charitable beneficiary. See Situation 2 of Rev. Rul. 88–82, 1988–2 C.B. 336, for the gift tax consequences of the payment of excess income to a noncharitable beneficiary. See section 5.06 for the private foundation rules applicable to charitable lead trusts.

(8) *Payment of part of annuity for private purposes.* In general, no part of a charitable lead annuity interest may be payable for a private purpose before the expiration of all charitable lead annuity interests. However, there are two exceptions to this rule. The first exception arises when the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Sections 20.2055–2(e)(2)(vi)(*f*) and 25.2522(c)–3(c)(2)(vi)(*f*). See section 5.06 for the private foundation rules applicable to charitable lead trusts.

.03 *Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust in Section 4.*

(1) *Prorating the annuity amount.* Paragraph 3, Proration of Annuity Amount, of the sample trust in section 4 provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.04 *Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of the Sample Trust in Section 4.*

(1) *Generation-skipping transfer tax.* If a CLAT has or may have a skip person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax. Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the donor to a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable rate is the inclusion ratio multiplied by the maximum federal estate tax rate. Section 2641(a). The rules for determining the inclusion ratio for a CLAT are set forth in § 2642(e), and confirm that the inclusion ratio is determined at the termination of the annuity period, rather than on the funding of the trust.

.05 *Annotation for Paragraph 5, Additional Contributions, of the Sample Trust in Section 4.*

(1) *Additions to the trust.* For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A CLAT that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.06 *Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust in Section 4.*

(1) *Prohibitions against certain investments and excess business holdings.* Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), are generally required. The sample trust in section 4 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust

instrument does not provide for the payment of excess income to a noncharitable beneficiary, the references to §§ 4943 and 4944 may be removed from the trust instrument. Section 4947(b)(3) and §§ 53.4947–2(b)(1)(i), 20.2055–2(e)(2)(vi)(*e*), and 25.2522(c)–3(c)(2)(vi)(*e*). See section 5.02(7) for a discussion of the payment of excess trust income to a noncharitable beneficiary. See section 5.02(8) for a discussion of the payment of part of the annuity for a private purpose.

.07 *Annotation for paragraph 7, Taxable Year, of the Sample Trust in Section 4.*

(1) *Calendar year.* The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.08 *Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust in Section 4.*

(1) *Capital gains.* Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law. Even if gains are allocated to principal, they will be deductible under § 642(c)(1) if they are paid to the charitable beneficiary as part of a charitable annuity payment. Rev. Rul. 83–75, 1983–1 C.B. 114.

.09 *Annotation for paragraph 11, Retained Powers and Interests, of the Sample Trust in Section 4.*

(1) *Trust not a grantor trust.* Paragraph 11, Retained Powers and Interests, of the sample trust in section 4 prohibits any person from holding any power or possessing any interest that would cause the donor to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. This prohibition should be included only in nongrantor charitable lead trusts. See section 7 for a sample grantor charitable lead annuity trust.

SECTION 6. ALTERNATE PROVISIONS FOR SAMPLE INTER VIVOS NONGRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 *Annuity Period for the Life of One Individual.*

(1) *Explanation.* As an alternative to establishing a CLAT for a term of years, the trust instrument of a nongrantor CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that each measuring life is a lineal ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries if there is a less than 15 percent probability at the time of the contribution to the trust that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031–7. Sections 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*).

(2) *Instruction for use.* Replace the fifth and sixth sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following sentences:

> The annuity period is the lifetime of [*designated measuring life*]. The first day of the annuity period shall be the date the property is transferred to the trust and the last day of the annuity period shall be the date of death of [*designated measuring life*].

.02 *Retention of the Right to Substitute the Charitable Lead Beneficiary.*

(1) *Explanation.* The donor to a nongrantor CLAT may retain the right to substitute another charitable beneficiary for the charitable beneficiary named in the trust instrument. Note, however, that the retention of this right will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending upon the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c).

(2) *Instruction for use.* Replace the third sentence of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

> Notwithstanding the preceding sentence, the Donor reserves the right to designate as the charitable annuity recipient, at any time and from time to time, in lieu of [*designated charitable recipient*], one or more organizations described in §§ 170(c), 2055(a), and 2522(a) and shall make any such designation by giving written notice to the Trustee. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient.

.03 *Apportionment of the Annuity Amount in the Discretion of the Trustee.*

(1) *Explanation.* The donor or the trustee of a nongrantor charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries. See § 674(b)(4). A power to apportion the annuity amount among a class of qualifying charitable beneficiaries that is retained by the donor or the donor's spouse will not cause the donor to be treated as the owner of the trust for income tax purposes. Section 674(b)(4). Note, however, that a retained power of apportionment by the donor, but not the donor's spouse, will cause the gift of the annuity interest to be incomplete for gift tax purposes and will cause some or all of the trust property to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c).

(2) *Instruction for use.* Replace the first three sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class comprised of organizations described in §§ 170(c), 2055(a), and 2522(a) (hereinafter, collectively "the Charitable Organization") an annuity amount equal to [*number representing the annual annuity percentage to be paid to the Charitable Organization*] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee's sole discretion, from time to time may deem advisable.

.04 *Annuity Amount as a Specific Dollar Amount.*

(1) *Explanation.* As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may instead be stated as a specific dollar amount.

(2) *Instructions for use.*

(a) Replace the first sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*the stated dollar amount*].

(b) Delete the last sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 concerning the incorrect valuation of trust assets.

.05 *Designation of an Alternate Charitable Beneficiary in the Trust Instrument.*

(1) *Explanation.* The sample trust in section 4 provides that in the event the charitable beneficiary designated in the trust instrument is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the trustee shall distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the trustee shall select. As an alternative, the trust instrument may specifically designate one or more alternate charitable beneficiaries.

(2) *Instruction for use.* Replace the second sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 4 with the following two sentences:

If [*designated charitable recipient*] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to [*designated substitute charitable recipient*]. If neither [*designated charitable recipient*] nor [*designated substitute charitable recipient*] is an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

SECTION 7. SAMPLE INTER VIVOS GRANTOR CHARITABLE LEAD ANNUITY TRUST

On this ________ day of ______________, 20_____, I, _____________ (hereinafter "the Donor"), desiring to establish a charitable lead annuity trust within the meaning of Rev. Proc. 2007–45 hereby enter into this trust agreement with _____________ as the initial trustee (hereinafter "the Trustee"). This trust shall be known as the _____________ Grantor Charitable Lead Annuity Trust. All references to "section" or "§" in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, *et seq.*

1. *Funding of Trust.* The Donor hereby transfers and irrevocably assigns to the Trustee on the above date, the property described in Schedule A, and the Trustee accepts the property and agrees to hold, manage, and distribute the property under the terms set forth in this trust instrument.

2. *Payment of Annuity Amount.* In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*number representing the annual annuity percentage to be paid to the designated charitable recipient*] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of the transfer. If [*designated charitable recipient*] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment

is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [*number of years of annuity period*] years. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the day preceding the [*ordinal number corresponding to the length of the annuity period*] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. *Proration of Annuity Amount.* The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year in which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. *Distribution Upon Termination of Annuity Period.* At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due to the Charitable Organization under the provisions above) to [*remainder beneficiary*].

5. *Additional Contributions.* No additional contributions shall be made to the trust after the initial contribution.

6. *Prohibited Transactions.* The Trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The Trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3). In addition, the Trustee shall not acquire any assets that would subject the trust to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

7. *Taxable Year.* The taxable year of the trust shall be the calendar year.

8. *Governing Law.* The operation of the trust shall be governed by the laws of the State of ______________. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the requirements for the charitable deductions available for contributions to a charitable lead annuity trust.

9. *Limited Power of Amendment.* This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the Charitable Organization is a guaranteed annuity interest under §§ 170(f)(2)(B), 2055(e)(2)(B), and 2522(c)(2)(B) and the regulations thereunder.

10. *Investment of Trust Assets.* Except as provided in paragraph 6 herein, nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

11. *Retained Powers and Interests.* During the Donor's life, [*individual other than the donor, the trustee, or a disqualified person as defined in § 4946(a)(1)*] shall have the right, exercisable only in a nonfiduciary capacity and without the consent or approval of any person acting in a fiduciary capacity, to acquire any property held in the trust by substituting other property of equivalent value.

SECTION 8. ANNOTATIONS REGARDING SAMPLE INTER VIVOS GRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 Annotations for Introductory Paragraph and Paragraph 1, Funding of Trust, of the Sample Trust in Section 7.

(1) *Types of charitable lead trusts.* An inter vivos charitable lead trust may be established as either a grantor charitable lead trust or a nongrantor charitable lead trust. The sample trust in section 7 is an example of a grantor charitable lead trust. The sample trust in section 4 is an example of a nongrantor charitable lead trust. In order for the donor to a charitable lead trust to claim an income tax charitable deduction under § 170(a) in the year of the donor's contribution to the trust for the present value of the annuity interest passing to charity, the trust must be structured as a grantor charitable lead trust. See § 170(f)(2)(B). The rules governing grantor charitable lead trusts are similar to those relating to nongrantor charitable lead trusts. The most significant difference is the income tax treatment of the trust income. A charitable lead trust is a grantor charitable lead trust if the donor to the trust is treated as the owner of the entire trust for income tax purposes. See section 8.09 for a discussion of the types of powers that may be used to create a grantor charitable lead trust.

(2) *Income taxation of grantor charitable lead trusts.* The donor to a grantor charitable lead annuity trust may claim a federal income tax charitable deduction under § 170(a) in the year that assets are irrevocably transferred to the trust. During the charitable lead annuity period, the donor is taxed on all income earned by the trust and does not receive any charitable

deduction under § 170 for the annuity payments to the charitable beneficiary as they are made. In addition, the trust does not receive a charitable deduction under § 642(c)(1). See § 1.671–4 for the income tax reporting requirements for a grantor charitable lead annuity trust.

(3) *Income tax deductibility limitations.* The donor to a grantor charitable lead trust may claim an income tax charitable deduction under § 170(a) equal to the present value of all future payments that are to be made to the charitable beneficiary. Section 1.170A–6(c). However, a contribution of a charitable income interest in property for which a deduction is allowable under § 170(a) is considered to be made "for the use of" rather than "to" a charitable organization. Section 1.170A–8(a)(2). Because the charitable lead interest of a grantor charitable lead trust is considered to be made "for the use of" the charitable beneficiary, the income tax charitable deduction available to an individual taxpayer is generally limited as set forth in § 170(b)(1)(B) to 30 percent of the taxpayer's contribution base as defined in § 170(b)(1)(G). However, if the property contributed to the CLAT is capital gain property as defined in § 170(b)(1)(C)(iv) and the charitable beneficiary (including any alternate charitable beneficiaries named in the trust instrument or selected by the trustee) is not limited to an organization described in § 170(b)(1)(A) (a "public charity"), the individual taxpayer's income tax charitable deduction generally is limited as set forth in § 170(b)(1)(D) to 20 percent of the taxpayer's contribution base. Section 170(b)(1)(D). See §§ 1.170A–8(c) and (d). In addition, the amount of a charitable contribution of certain types of property may be reduced under § 170(e). See § 1.170A–4. See section 9.06 for an alternate provision that restricts the charitable beneficiary to a public charity.

(4) *Charitable lead beneficiary requirements.* A deduction is allowed under § 170(a) for contributions to a grantor CLAT only if the charitable lead beneficiary is an organization described in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 170(a) differs from the class of permissible charitable recipients for obtaining a deduction under § 642(c)(1). Compare § 170(c) with § 1.642(c)–(1)(a)(2).

(5) *Computation of charitable deduction.* In general, the income, estate, and gift tax charitable deductions available under §§ 170(a), 2055(e)(2)(B), and 2522(c)(2)(B) with respect to contributions to a CLAT are equal to the present value of the annuity interest. Section 7520 generally requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See §§ 1.7520–2, 20.7520–2, and 25.7520–2. If, however, the circumstances surrounding the transfer to a charitable lead trust suggest that the charitable beneficiary might not receive the beneficial enjoyment of the annuity interest, an income tax deduction will be allowed only for the minimum possible amount that the charity will receive. Section 1.170A–6(c)(3)(iii). If at any time the donor ceases to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code, the donor shall be considered to have received an amount of income equal to the amount of any deduction the donor received under § 170(a) for the contribution to the trust, reduced by the discounted value (as of the date of the contribution to the trust) of all amounts of income earned by the trust and taxable to the donor before the time that the donor ceased to be treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. Section 170(f)(2)(B).

(6) *Trustee provisions.* The trust instrument may name alternate or successor trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain other administrative provisions relating to the trustee's duties and powers.

(7) *Identity of donor.* For purposes of qualification under this revenue procedure, the donor to a charitable lead annuity trust may be an individual or a husband and wife. Appropriate adjustments should be made to the introductory paragraph if a husband and wife are the donors. Terms such as "grantor" or "settlor" may be substituted for "donor."

.02 Annotations for Paragraph 2, Payment of Annuity Amount, of the Sample Trust in Section 7.

(1) *Guaranteed annuity.* To qualify for the applicable charitable deductions, a grantor CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See §§ 170(c), 2055(e)(2)(B), and 2522(c)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 8.02(4) for a discussion of the permissible term of a grantor CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained at the time of the transfer to the trust. Sections 1.170A–6(c)(2)(i)(A), 20.2055–2(e)(2)(vi)(*a*), and 25.2522(c)–3(c)(2)(vi)(*a*). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a sum certain or a fixed percentage of the trust assets (determined annually), is not a guaranteed annuity interest. See §§ 1.170A–6(c)(2)(i)(B), 20.2055–2(e)(2)(vi)(*b*), and 25.2522(c)–3(c)(2)(vi)(*b*). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88–27, 1988–1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the date of gift exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Sections 1.170A–6(c)(2)(i)(D), 20.2055–2(e)(2)(vi)(*e*), and 25.2522(c)–3(c)(2)(vi)(*e*).

These prohibitions are contained in the sample trust in section 7. See section 8.06 for a further discussion of the 60 percent test. See section 9.04 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

(2) *Payment requirements.* CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the donor will realize capital gain on the assets distributed to satisfy part or all of the annuity payment.

(3) *Rule against perpetuities.* An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. Sections 1.170A–6(c)(2)(i)(A), 20.2055–2(e)(2)(vi)(*a*), and 25.2522(c)–3(c)(2)(vi)(*a*).

(4) *Permissible term.* Paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for payment of the annuity amount for the life or lives of one or more measuring lives or for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85–49, 1985–1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the date assets are transferred to the trust. Sections 1.170A–6(c)(2)(i)(A), 20.2055–2(e)(2)(vi)(*a*) and 25.2522(c)–3(c)(2)(vi)(*a*). See section 9.01 for an alternate provision that provides for an annuity period based on the life of an individual.

(5) *Permissible recipients.* A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the donor from receiving a charitable deduction if the trust instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c), 2055(a), and 2522(a). Rev. Rul. 78–101, 1978–1 C.B. 301. If it is determined that a deduction under § 2055(a) will not be necessary in any event, all references to § 2055(a) in the trust instrument may be deleted. Note, that if the donor is serving as trustee of the trust, the trustee's power to select the charitable beneficiaries will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c). Further note that if the charitable beneficiary is a private foundation and the donor is an officer or director of the private foundation or possesses certain decision making authority in the private foundation, some or all of the trust property may be included in the donor's gross estate. See § 2036(a)(2). See section 8.01(3) for a discussion of the income tax deductibility limitations. See section 9.02 for an alternate provision that provides for a donor's retained right to substitute the charitable beneficiary. See section 9.03 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable beneficiaries. See section 9.06 for an alternate provision that limits the charitable beneficiary to a public charity.

(6) *Payment of annuity amount in installments.* Paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 specifies that the annuity amount is to be paid in equal quarterly installments at the end of each calendar quarter. Alternatively, the trust instrument may specify that the annuity amount is to be paid in annual or other equal or unequal installments throughout the year. See §§ 1.170A–6(c)(2)(i)(A), 20.2055–2(e)(2)(vi)(*a*), and 25.2522(c)–3(c)(2)(vi)(*a*). The amount of the charitable deduction will be affected by the frequency of the payment, by whether the installments are equal or unequal, and by whether each installment is payable at the beginning or end of the period. See §§ 1.170A–6, 25.2512–5, and 20.2031–7.

(7) *Excess income.* Trust income in excess of the amount required to pay the annuity may be retained by the trust or distributed to the charitable beneficiary. The sample trust in section 7 provides for the retention of excess income by the trust. If, instead, the governing instrument of a grantor charitable lead trust provides for the payment of excess income to or for the use of the charitable beneficiary, the donor will receive an income tax charitable deduction each year for amounts paid to a charitable beneficiary to the extent that such amounts exceed the guaranteed annuity amount. Section 1.170A–6(d)(2)(ii). However, the donor is not entitled to any additional estate or gift tax charitable deductions for the excess amounts of income distributed to the charitable beneficiary. See §§ 20.2055–2(e)(2)(vi)(*d*) and 25.2522(c)–3(c)(2)(vi)(*d*). See Situation 2 of Rev. Rul. 88–82, 1988–2 C.B. 336, for the gift tax consequences of the payment of excess income to a noncharitable beneficiary. See section 8.06 for the private foundation rules applicable to charitable lead trusts.

(8) *Payment of part of annuity for private purposes.* In general, no part of a charitable lead annuity interest may be payable for a private purpose before the expiration of all charitable lead annuity interests. However, there are two exceptions to this rule. The first exception arises when the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the

amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Sections 1.170A–6(c)(2)(i)(E), 20.2055–2(e)(2)(vi)(*f*), and 25.2522(c)–3(c)(2)(vi)(*f*). See section 8.06 for the private foundation rules applicable to charitable lead trusts.

.03 *Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust in Section 7.*

(1) *Prorating the annuity amount.* Paragraph 3, Proration of Annuity Amount, of the sample trust in section 7 provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.04 *Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of the Sample Trust in Section 7.*

(1) *Generation-skipping transfer tax.* If a CLAT has or may have a skip person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax. Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the donor of a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable rate is the inclusion ratio multiplied by the maximum federal estate tax rate. Section 2641(a). The rules for determining the inclusion ratio for a CLAT are set forth in § 2642(e) and confirm that the inclusion ratio is determined at the termination of the annuity period, rather than on the funding of the trust.

.05 *Annotation for Paragraph 5, Additional Contributions, of the Sample Trust in Section 7.*

(1) *Additions to the trust.* For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A charitable lead trust that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.06 *Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust in Section 7.*

(1) *Prohibitions against certain investments and excess business holdings.* Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3) are generally required. The sample trust in section 7 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust instrument does not provide for the payment of excess income to a noncharitable beneficiary, the references to §§ 4943 and 4944 may be removed from the trust instrument. Sections 4947(b)(3), 53.4947–2(b)(1)(i), 1.170A–6(c)(2)(i)(D), 20.2055–2(e)(2)(vi)(*e*), and 25.2522(c)–3(c)(2)(vi)(*e*). See section 8.02(7) for a discussion of the payment of excess trust income to a noncharitable beneficiary. See section 8.02(8) for a discussion of the payment of part of the annuity for a private purpose.

.07 *Annotation for paragraph 7, Taxable Year, of the Sample Trust in Section 7.*

(1) *Calendar year.* The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.08 *Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust in Section 7.*

(1) *Capital gains.* Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law.

.09 *Annotation for Paragraph 11, Retained Powers and Interests, of the Sample Trust in Section 7.*

(1) *Power to substitute trust assets.* The donor to a CLAT may claim an income tax charitable deduction under § 170(a) if the donor is treated as the owner of the entire CLAT under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. Paragraph 11, Retained Powers and Interests, of the sample trust in section 7 creates a grantor CLAT through the use of a power to substitute trust assets under § 675(4) that is held by a person other than the donor, the trustee, or a disqualified person as defined in § 4946(a)(1), and is exercisable only in a nonfiduciary capacity. The circumstances surrounding the administration of a CLAT will determine whether a § 675(4) substitution power is exercised in a fiduciary

or nonfiduciary capacity. This is a question of fact. Note, that the exercise of a § 675(4) power may result in an act of self-dealing under § 4941.

(2) *Other powers or provisions to create a grantor trust.* As noted above, the sample trust in section 7 includes a § 675(4) power that is held by someone other than donor, the trustee, or a disqualified person as defined in § 4946(a)(1), and that may be exercised only in a nonfiduciary capacity. The CLAT instrument may instead incorporate a power or provision, other than the one provided in sample trust in section 7, that will cause the donor to be treated as the owner of the entire CLAT under the provisions of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code. See § 671 *et seq.* However, practitioners should exercise caution when choosing a particular power or provision because certain methods of creating a grantor trust may have unforeseen tax consequences.

SECTION 9. ALTERNATE PROVISIONS FOR SAMPLE INTER VIVOS GRANTOR CHARITABLE LEAD ANNUITY TRUST

.01 *Annuity Period for the Life of One Individual.*

(1) *Explanation.* As an alternative to establishing a CLAT for a term of years, the trust instrument of a grantor CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170, 2055, or 2522), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that each measuring life is a lineal ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries if there is a less than 15 percent probability at the time of the contribution to the trust that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031–7. Sections 1.170A–6(c)(2)(i)(A), 20.2055–2(e)(2)(vi)(*a*), and 25.2522(c)–3(c)(2)(vi)(*a*).

(2) *Instruction for use.* Replace the fifth and sixth sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following sentences:

The annuity period is the lifetime of [*designated measuring life*]. The first day of the annuity period shall be the date the property is transferred to the trust, and the last day of the annuity period shall be the date of death of [*designated measuring life*].

.02 *Retention of the Right to Substitute the Charitable Lead Beneficiary.*

(1) *Explanation.* The donor to a grantor CLAT may retain the right to substitute another charitable beneficiary for the charitable beneficiary named in the trust instrument and still claim a deduction under § 170(a) in the year of the transfer to the CLAT. Note, however, that the retention of this right will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property (depending on the date of the donor's death) to be included in the donor's gross estate. See §§ 2035, 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c). See section 8.01(3) for a discussion of the income tax deductibility limitations applicable to contributions to a grantor CLAT.

(2) *Instruction for use.* Replace the third sentence of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

Notwithstanding the preceding sentence, the Donor reserves the right to designate as the charitable annuity recipient, at any time and from time to time, in lieu of [*designated charitable recipient named above*], one or more organizations described in §§ 170(c), 2055(a), and 2522(a) and shall make any such designation by giving written notice to the Trustee. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient.

.03 *Apportionment of the Annuity Amount in the Discretion of the Trustee.*

(1) *Explanation.* The donor or the trustee of a grantor charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries. Note that a retained power of apportionment by the donor will cause the gift of the annuity interest to be incomplete for gift tax purposes and may cause some or all of the trust property to be included in the donor's gross estate. See §§ 2035(a), 2036(a)(2), and 2038(a)(1) and § 25.2511–2(c).

(2) *Instruction for use.* Replace the first three sentences of paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class comprised of organizations described in §§ 170(c), 2055(a), and 2522(a) (hereinafter, collectively "the Charitable Organization") an annuity amount equal to [*number representing the annual annuity percentage to be paid to the Charitable Organization*] percent of the initial net fair market value of all property transferred to the trust, valued as of the date of

the transfer. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee's sole discretion, from time to time may deem advisable.

.04 *Annuity Amount as a Specific Dollar Amount.*

(1) *Explanation.* As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may be stated as a specific dollar amount.

(2) *Instructions for use.*

(a) Replace the first sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*the stated dollar amount*].

(b) Delete the last sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 concerning the incorrect valuation of trust assets.

.05 *Designation of an Alternate Charitable Beneficiary in the Trust Instrument.*

(1) *Explanation.* The sample trust in section 7 provides that if the charitable beneficiary designated in the trust instrument is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the trustee shall distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the trustee shall select. As an alternative, the trust instrument may specifically designate one or more alternate charitable beneficiaries. See section 8.01(3) for a discussion of the income tax deductibility limitations applicable to contributions to a grantor CLAT.

(2) *Instruction for use.* Replace the second sentence in paragraph 2, Payment of Annuity Amount, of the sample trust in section 7 with the following two sentences:

If [*designated charitable recipient*] is not an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to [*designated substitute charitable recipient*]. If neither [*designated charitable recipient*] nor [*designated substitute charitable recipient*] is an organization described in §§ 170(c), 2055(a), and 2522(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c), 2055(a), and 2522(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

.06 *Restriction of the Charitable Beneficiary to a Public Charity.*

(1) *Explanation.* Because the charitable lead interest of a grantor charitable lead trust is considered to be made "for the use of" the charitable beneficiary, the income tax charitable deduction available to an individual taxpayer is generally limited as set forth in § 170(b)(1)(B) to 30 percent of the taxpayer's contribution base as defined in § 170(b)(1)(G). However, if the property contributed to the CLAT is capital gain property as defined in § 170(b)(1)(C)(iv) and the charitable beneficiary (including any alternate charitable beneficiaries named in the trust instrument or selected by the trustee) is not limited to a public charity, the individual taxpayer's income tax charitable deduction generally is limited as set forth in § 170(b)(1)(D) to 20 percent of the taxpayer's contribution base. Section 170(b)(1)(D). See §§ 1.170A–8(c) and (d). In addition, the amount of a charitable contribution of certain types of property may be reduced under § 170(e). See § 1.170A–4.

(2) *Instructions for use.* To restrict the charitable beneficiary to a public charity, each and every time the phrase "an organization described in §§ 170(c), 2055(a), and 2522(a) of the Code" appears in the sample trust, replace it with the phrase "an organization described in §§ 170(b)(1)(A), 170(c), 2055(a), and 2522(a) of the Code."

SECTION 10. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephanie N. Bland of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Stephanie N. Bland at (202) 622–3090 or (202) 622–7830 (not a toll-free call).

26 CFR 601.201: Rulings and determination letters.
(Also: Part I, §§ 642(c), 2055; § 20.2055–2.)

Rev. Proc. 2007–46

SECTION 1. PURPOSE

This revenue procedure contains an annotated sample declaration of trust and alternate provisions that meet the requirements for a testamentary charitable lead annuity trust (CLAT) providing for annuity payments payable to one or more charitable beneficiaries for the annuity period followed by the distribution of trust assets to one or more noncharitable remaindermen.

SECTION 2. BACKGROUND

The Internal Revenue Service (Service) is issuing sample forms for CLATs; annotations and alternate sample provisions are included as further guidance. In addition to the sample trust instrument for a testamentary CLAT that is included in this revenue procedure, samples are provided in a separate revenue procedure for grantor and nongrantor inter vivos CLATs (see Rev. Proc. 2007–45, 2007–29 I.R.B. 89).

SECTION 3. SCOPE

A CLAT is an irrevocable split-interest trust that provides for a specified amount to be paid to one or more charitable beneficiaries during the term of the trust. The principal remaining in the trust at the end of the term is paid over to, or held in a continuing trust for, a noncharitable beneficiary or beneficiaries identified in the trust. If the terms of a CLAT created on the decedent's death satisfy the applicable statutory and regulatory requirements, the value of the charitable lead annuity interest will be deductible by the decedent's estate under § 2055(e)(2)(B) and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by § 642(c)(1).

A testamentary CLAT is subject to the provisions of part I, subchapter J of chapter 1 of subtitle A of the Internal Revenue Code (Code). Under the provisions of part I of subchapter J, a CLAT is allowed a deduction under § 642(c)(1) in determining its taxable income for any amount of gross income paid for purposes specified in § 170(c).

Section 4 of this revenue procedure provides a sample declaration of trust for a testamentary CLAT with a term of years annuity period that is created by a decedent who was a citizen or resident of the United States. Section 5 of this revenue procedure provides annotations to the provisions of the sample trust. Section 6 of this revenue procedure provides samples of certain alternate provisions concerning: (.01) an annuity period for the life of an individual; (.02) apportionment of the annuity amount in the discretion of the trustee; (.03) the annuity amount as a specific dollar amount; and (.04) designation of an alternate charitable beneficiary in the trust instrument. If a trust is substantially similar to the sample trust in section 4 of this revenue procedure or properly integrates one or more alternate provisions from section 6 into a document substantially similar to the sample trust in section 4, is a valid trust under applicable local law, and operates in a manner consistent with the terms of the instrument, and if all other deductibility requirements are satisfied, the value of the charitable lead interest will be deductible by the decedent's estate under § 2055(e)(2)(B) and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by § 642(c)(1). In addition, a testamentary CLAT will qualify for the safe harbor created under this revenue procedure if the trust satisfies all of the requirements set forth in the preceding sentence, except that it defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust and/or provides for a different disposition of trust assets upon the termination of the annuity period.

Except as provided above, a trust that contains substantive provisions in addition to those provided in section 4 of this revenue procedure (other than properly integrated alternate provisions from section 6 of this revenue procedure or provisions necessary to establish a valid trust under applicable local law that are not inconsistent with the applicable federal tax requirements), or that omits any of the provisions of section 4 of this revenue procedure (unless an alternate provision from section 6 of this revenue procedure is properly integrated), will not necessarily be ineligible for the relevant charitable deduction(s), but neither will that trust (or contributions to it) be assured of qualification for the appropriate charitable deductions. The Service generally will not issue a letter ruling on whether a testamentary CLAT qualifies for income and estate tax charitable deductions. The Service, however, generally will issue letter rulings relating to the tax consequences of the inclusion in a CLAT of substantive trust provisions other than those contained in sections 4 and 6 of this revenue procedure.

SECTION 4. SAMPLE TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

I give, devise, and bequeath [*property bequeathed*] to my Trustee in trust to be administered under this provision. I intend this bequest to establish a charitable lead annuity trust, within the meaning of Rev. Proc. 2007–46. This trust shall be known as the

______________ Charitable Lead Annuity Trust, and I hereby designate ______________ as the initial trustee (hereinafter "the Trustee"). All references to "section" or "§" in this instrument shall refer to the Internal Revenue Code of 1986, 26 U.S.C. § 1, *et seq.*

1. *Payment of Annuity Amount.* In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*number representing the annual annuity percentage to be paid to the designated charitable recipient*] percent of the initial net fair market value of all property passing to this trust, as finally determined for federal estate tax purposes. If [*designated charitable recipient*] is not an organization described in §§ 170(c) and 2055(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c) and 2055(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion. The term "the Charitable Organization" shall be used herein to refer collectively to the organization(s) then constituting the charitable recipient, whether named in this paragraph or subsequently selected as the substitute charitable recipient. During the trust term, no payment shall be made to any person other than the Charitable Organization. The annuity period is a term of [*number of years of annuity period*] years. The first day of the annuity period shall be the date of my death, and the last day of the annuity period shall be the day preceding the [*ordinal number corresponding to the length of the annuity period*] anniversary of that date. The annuity amount shall be paid in equal quarterly installments at the end of each calendar quarter from income and, to the extent income is not sufficient, from principal. Any income of the trust for a taxable year in excess of the annuity amount shall be added to principal. If the initial net fair market value of the trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal estate tax purposes, the Trustee shall pay to the Charitable Organization (in the case of an undervaluation) or receive from the Charitable Organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. *Deferral Provision.* The obligation to pay the annuity amount shall commence with the date of my death, but payment of the annuity amount may be deferred from this date until the end of the taxable year in which the trust is completely funded. Within a reasonable time after the end of the taxable year in which the trust is completely funded, the Trustee must pay to the Charitable Organization the difference between any annuity amounts actually paid and the annuity amounts payable, plus interest. The interest for any period shall be computed at the § 7520 rate of interest in effect for the date of my death. All interest shall be compounded annually.

3. *Proration of Annuity Amount.* The Trustee shall prorate the annuity amount on a daily basis for any short taxable year. In the taxable year in which the annuity period ends, the Trustee shall prorate the annuity amount on a daily basis for the number of days of the annuity period in that taxable year.

4. *Distribution Upon Termination of Annuity Period.* At the termination of the annuity period, the Trustee shall distribute all of the then principal and income of the trust (other than any amount due to the Charitable Organization under the provisions above) to [*remainder beneficiary*].

5. *Additional Contributions.* No additional contributions shall be made to the trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The Trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3). In addition, the Trustee shall not acquire any assets that would subject the trust to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the Trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

7. *Taxable Year.* The taxable year of the trust shall be the calendar year.

8. *Governing Law.* The operation of the trust shall be governed by the laws of the State of ______________. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the requirements for the charitable deductions available to a charitable lead annuity trust or for contributions to a charitable lead annuity trust.

9. *Limited Power of Amendment.* This trust is irrevocable. However, the Trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the Charitable Organization is a guaranteed annuity interest under § 2055(e)(2)(B) and the regulations thereunder and that payments of the annuity amount to the Charitable Organization will be deductible from the gross income of the trust to the extent provided by § 642(c)(1) and the regulations thereunder.

10. *Investment of Trust Assets.* Except as provided in paragraph 6 herein, nothing in this trust instrument shall be construed to restrict the Trustee from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets.

SECTION 5. ANNOTATIONS REGARDING SAMPLE TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

.01 *Annotations for Introductory Paragraph of the Sample Trust.*

(1) *Income taxation of testamentary charitable lead trusts.* A testamentary CLAT is a complex trust that is taxable as a separate entity under the provisions of subchapter J of the Code. The trustee of the trust must apply for a tax identification number for the trust.

(2) *Deduction under § 642(c)(1) available for amounts paid for a charitable purpose.* Under § 642(c)(1), a testamentary CLAT is allowed a deduction in computing its taxable income for any amount of gross income, without limitation, that under the terms of the trust instrument is paid for a purpose specified in § 170(c) (determined without regard to § 170(c)(2)(A)) during the taxable year. Section 642(c)(1) and § 1.642(c)–1(a). An amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in § 170(c)(2) shall be considered paid for a purpose described in § 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any state, the District of Columbia, or any possession of the United States. Section 1.642(c)–1(a)(2). With regard to amounts of income paid to the charitable beneficiary after the close of the taxable year in which the income was received (but on or before the last day of the next succeeding taxable year), the trustee of a testamentary CLAT may elect to take the charitable deduction for that payment for the year in which the income was received, rather than for the year in which the payment was made. Section 642(c)(1). The election is made by filing a statement with the income tax return for the taxable year in which the charitable contribution is treated as paid. See § 1.642(c)–1(b).

(3) *Charitable lead beneficiary requirements.* A deduction is allowed under § 642(c)(1) for any amount of the gross income of a testamentary CLAT that is paid for a purpose specified in § 170(c). Note that the class of permissible charitable recipients for obtaining a deduction under § 642(c)(1) differs from the class of permissible charitable recipients for obtaining a deduction under § 170(a). Compare § 170(c) and § 1.642(c)–1(a)(2).

(4) *Unrelated business taxable income.* Under § 681, a testamentary charitable lead trust's deduction under § 642(c)(1) is disallowed in any year to the extent that the deduction is allocable to the trust's unrelated business taxable income, as defined in § 512, for that taxable year. See § 1.681(a)–2. However, a partial deduction is allowed under § 512(b)(11) for amounts allocable to unrelated business taxable income. Section 512(b)(11). See § 512(b)(12) and § 1.681(a)–2(a).

(5) *Computation of estate tax charitable deduction.* In general, the estate tax charitable deduction available under § 2055(e)(2)(B) with respect to contributions to a CLAT is equal to the present value of the annuity interest. Section 7520 requires that an annuity interest must be valued using tables published by the Service. The method for valuing a charitable lead annuity interest is set forth in the regulations. See § 20.7520–2. If estate or other death taxes are paid from the assets used to fund a testamentary CLAT, the amount deductible under § 2055 is the amount that passes to charity, reduced by the amount of estate or death taxes paid. Section 2055(c).

(6) *Trustee provisions.* The trust instrument may name alternate or successor trustees and/or may include a process for the appointment of unnamed alternate or successor trustees. In addition, the trust instrument may contain certain administrative provisions relating to the trustee's duties and powers.

.02 *Annotations for Paragraph 1, Payment of Annuity Amount, of the Sample Trust.*

(1) *Guaranteed annuity.* To qualify for an estate tax charitable deduction, a CLAT must provide for the payment of a guaranteed annuity amount at least annually to a qualified charitable organization for each year during the annuity period. See § 2055(e)(2)(B). A guaranteed annuity is an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years or for one or more measuring lives. See section 5.02(4) for a discussion of the permissible term of a testamentary CLAT. An amount is determinable if the exact amount that must be paid under the conditions specified in the instrument of transfer may be ascertained as of the appropriate valuation date. Section 20.2055–2(e)(2)(vi)(*a*). A charitable interest expressed as the right to receive an annual payment from a trust equal to the lesser of a sum certain or a fixed percentage of the trust assets (determined annually) is not a guaranteed annuity interest. See § 20.2055–2(e)(2)(vi)(*b*). In addition, a charitable lead annuity interest is not a guaranteed annuity interest if the trustee has the discretion to commute and prepay the charitable interest prior to the termination of the annuity period. Rev. Rul. 88–27, 1988–1 C.B. 331. If a charitable interest in the form of a guaranteed annuity interest is in trust and the present value of the charitable interest on the appropriate valuation date exceeds 60 percent of the aggregate value of all amounts in the trust, the charitable interest will not be considered a guaranteed annuity interest unless the governing instrument of the trust prohibits the acquisition and retention of assets that would give rise to a tax under § 4943 or 4944, as modified by §§ 4947(a)(2) and 4947(b)(3). Section 20.2055–2(e)(2)(vi)(*e*). These prohibitions are contained in the sample trust in section 4. See section 5.07 for a further discussion of the 60 percent test. See section 6.03 for an alternate provision that provides for an annuity amount stated as a specific dollar amount.

(2) *Payment requirements*. CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time of the decedent's death. The annuity payments may be made in cash or in kind. If the trustee distributes appreciated property in satisfaction of the required annuity payment, the trust will realize capital gain on the assets distributed to satisfy part or all of the annuity payment and the trust will be allowed a § 642(c)(1) deduction for the realized capital gains. Rev. Rul. 83–75, 1983–1 C.B. 114. See section 5.03 for a discussion of the deferral of the requirement to pay the annuity amount until the end of the taxable year in which the trust is completely funded.

(3) *Rule against perpetuities*. An interest payable for a specified term of years may qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. However, any such savings clause must utilize a period of vesting of not more than 21 years after the deaths of the measuring lives who are selected to maximize, rather than limit, the term of the trust. Section 20.2055–2(e)(2)(vi)(*a*).

(4) *Permissible term*. Paragraph 1, Payment of Annuity Amount, of the sample trust provides for payment of the annuity amount for a specified term of years. Alternatively, the trust instrument may provide for payment of the annuity amount for the life or lives of one or more measuring lives or for the life or lives of one or more measuring lives plus a term of years. Rev. Rul. 85–49, 1985–1 C.B. 330. Only one or more of the following individuals may be used as measuring lives: the decedent's spouse and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170 or 2055), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. Each person used as a measuring life for the annuity period must be living on the decedent's date of death. Section 20.2055–2(e)(2)(vi)(*a*). See section 6.01 for an alternate provision that provides for an annuity period based on the life of an individual.

(5) *Permissible recipients*. A CLAT must have one or more charitable lead beneficiaries. The failure to designate a specific charitable beneficiary will not preclude the decedent's estate from receiving a charitable deduction if the trust instrument provides for the selection by the trustee of a charitable beneficiary described in §§ 170(c) and 2055(a). Rev. Rul. 78–101, 1978–1 C.B. 301. See section 6.02 for an alternate provision that provides the trustee with the power to apportion the annuity amount among charitable beneficiaries.

(6) *Payment of annuity amount in installments*. Paragraph 1, Payment of Annuity Amount, of the sample trust specifies that the annuity amount is to be paid in equal quarterly installments at the end of each calendar quarter. Alternatively, the trust instrument may specify that the annuity amount is to be paid in annual or other equal or unequal installments throughout the year. See § 20.2055–2(e)(2)(vi)(*a*). The amount of the charitable deduction will be affected by the frequency of the payment, by whether the installments are equal or unequal, and by whether each installment is payable at the beginning or end of the period. See § 20.2031–7.

(7) *Excess income*. Trust income in excess of the amount required to pay the annuity may be retained by the trust or distributed currently to the charitable beneficiary. The sample trust in section 4 provides for the retention of excess income by the trust. If, instead, the governing instrument provides for the payment of excess income to or for the use of the charitable beneficiary, no additional estate tax charitable deduction is available for the excess amounts of income distributed to the charitable beneficiary. See § 20.2055–2(e)(2)(vi)(*d*). However, the trust is entitled to a charitable income tax deduction under § 642(c)(1) for any amounts of excess income paid to the charitable beneficiary. See Situation 2 of Rev. Rul. 88–82, 1988–2 C.B. 336, for the transfer tax consequences of the payment of excess income to a noncharitable beneficiary. See section 5.07 for the private foundation rules applicable to charitable lead trusts.

(8) *Payment of part of annuity for private purposes*. In general, no part of a charitable lead annuity interest may be payable for a private purpose before the expiration of all charitable lead annuity interests. However, there are two exceptions to this rule. The first exception arises when the amount payable for a private purpose is in the form of a guaranteed annuity interest and the trust's governing instrument does not provide for any preference or priority in the payment of the private annuity as opposed to the charitable annuity. The second exception arises when, under the trust's governing instrument, the amount that may be paid for a private purpose is payable only from a group of assets that is devoted exclusively to private purposes and to which § 4947(a)(2) is inapplicable by reason of § 4947(a)(2)(B). Note that an amount is not deemed to have been paid for a private purpose if it was paid for full and adequate consideration in money or money's worth. Section 20.2055–2(e)(2)(vi)(*f*). See section 5.07 for the private foundation rules applicable to charitable lead trusts.

.03 *Annotations for Paragraph 2, Deferral Provision, of the Sample Trust.*

(1) *Deferral of requirement to pay annuity amount*. The deferral provision in paragraph 2 of the sample trust authorizes the trustee to defer the payment of the annuity amount until the end of the taxable year of the trust in which the trust is completely funded.

(2) *Interest on annuity payments*. The deferral provision in paragraph 2 of the sample trust provides for the payment of interest, compounded annually, with respect to any underpayment of the annuity amount during the period of estate administration.

The sample trust requires that interest be computed at the § 7520 rate in effect on the date of the decedent's death. To the extent that interest payable under state law exceeds the applicable § 7520 rate, the payment of interest at the rate prescribed by state law will be deemed to satisfy the interest payment requirement set forth in the trust instrument.

.04 *Annotation for Paragraph 3, Proration of Annuity Amount, of the Sample Trust.*

(1) *Prorating the annuity amount.* Paragraph 3, Proration of Annuity Amount, of the sample trust provides for the proration of the annuity amount in any short taxable year, including the last year of the annuity period.

.05 *Annotation for Paragraph 4, Distribution Upon Termination of Annuity Period, of the Sample Trust.*

(1) *Generation-skipping transfer tax.* If a CLAT has or may have a skip person, as defined in § 2613(a), as a remainder beneficiary, the transfer to the trust will be subject to the generation-skipping transfer (GST) tax. Under § 2651(f)(3), a charitable organization is deemed to be in the same generation as the decedent/donor of a charitable lead trust. Therefore, the GST potential of a charitable lead trust is dependent upon whether any noncharitable beneficiary is a skip person. GST tax liability is determined by multiplying the taxable amount by the applicable rate. The applicable rate is the inclusion ratio multiplied by the maximum federal estate tax rate. Section 2641(a). The rules for determining the inclusion ratio for a CLAT are set forth in § 2642(e) and confirm that the inclusion ratio is determined at the termination of the annuity period, rather than on the funding of the trust.

.06 *Annotation for Paragraph 5, Additional Contributions, of the Sample Trust.*

(1) *Additions to the trust.* For purposes of qualification under this revenue procedure, the trust instrument must contain a provision that prohibits additional contributions. A CLAT that permits additional contributions will not qualify for safe harbor treatment under this revenue procedure.

.07 *Annotation for Paragraph 6, Prohibited Transactions, of the Sample Trust.*

(1) *Prohibitions against certain investments and excess business holdings.* Prohibitions against retaining any excess business holdings within the meaning of § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), and against investments that jeopardize the exempt purpose of the trust within the meaning of § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3), are generally required. The sample trust in section 4 contains prohibitions against §§ 4943 and 4944 transactions. If the present value of the charitable interest does not exceed 60 percent of the aggregate value of all amounts in the trust, the trust instrument does not provide for the payment of any of the income interest to a noncharitable beneficiary, and the trust instrument does not provide for the payment of excess income to a noncharitable beneficiary, the references to §§ 4943 and 4944 may be removed from the trust instrument. Section 4947(b)(3) and §§ 53.4947–2(b)(1)(i) and 20.2055–2(e)(2)(vi)(*e*). See section 5.02(7) for a discussion of the payment of excess trust income to a noncharitable beneficiary. See section 5.02(8) for a discussion of the payment of part of the annuity for a private purpose.

.08 *Annotation for paragraph 7, Taxable Year, of the Sample Trust.*

(1) *Calendar year.* The taxable year of a charitable lead trust must be a calendar year. Section 644(a).

.09 *Annotation for paragraph 10, Investment of Trust Assets, of the Sample Trust.*

(1) *Capital gains.* Gains from the sale or exchange of capital assets may be allocated to the income or the principal of the trust. If the governing instrument is silent, capital gains are allocated in accordance with local law. Even if gains are allocated to principal, they will be deductible under § 642(c)(1) if they are paid to the charitable beneficiary as part of a charitable annuity payment. Rev. Rul. 83–75, 1983–1 C.B. 114.

SECTION 6. ALTERNATE PROVISIONS FOR SAMPLE TESTAMENTARY CHARITABLE LEAD ANNUITY TRUST

.01 *Annuity Period for the Life of One Individual.*

(1) *Explanation.* As an alternative to establishing a CLAT for a term of years, the trust instrument of a testamentary CLAT may provide for payment of the annuity amount for the life or lives of an individual or individuals. However, only one or more of the following individuals may be used as measuring lives: the decedent's spouse and an individual who, with respect to all remainder beneficiaries (other than charitable organizations described in § 170 or 2055), is either a lineal ancestor or the spouse of a lineal ancestor of those beneficiaries. A trust will satisfy the requirement that each measuring life is a lineal

ancestor (or the spouse of a lineal ancestor) of all noncharitable remainder beneficiaries, if on decedent's date of death there is a less than 15 percent probability that individuals who are not lineal descendants of an individual who is a measuring life will receive any trust principal. The probability must be computed under the applicable tables in § 20.2031–7. Section 20.2055–2(e)(2)(vi)(*a*).

(2) *Instruction for use.* Replace the fifth and sixth sentences of paragraph 1, Payment of Annuity Amount, of the sample trust with the following sentences:

The annuity period is the lifetime of [*designated measuring life*]. The first day of the annuity period shall be the date of my death, and the last day of the annuity period shall be the date of death of [*designated measuring life*].

.02 *Apportionment of the Annuity Amount in the Discretion of the Trustee.*

(1) *Explanation.* The trustee of a testamentary charitable lead trust may be granted the power to apportion the annuity payment from time to time among a class of qualifying charitable beneficiaries.

(2) *Instruction for use.* Replace the first three sentences of paragraph 1, Payment of Annuity Amount, of the sample trust with the following two sentences:

In each taxable year of the trust during the annuity period, the Trustee shall pay to one or more members of a class comprised of organizations described in §§ 170(c) and 2055(a) (hereinafter, collectively "the Charitable Organization") an annuity amount equal to [*number representing the annual annuity percentage to be paid to the Charitable Organization*] percent of the initial net fair market value of all property passing to this trust, as finally determined for federal tax purposes. The Trustee may pay the annuity amount to one or more members of the class, in equal or unequal shares, as the Trustee, in the Trustee's sole discretion, from time to time may deem advisable.

.03 *Annuity Amount as a Specific Dollar Amount.*

(1) *Explanation.* As an alternative to stating the annuity amount as a percentage of the initial net fair market value of the assets transferred to the trust, the annuity amount may instead be stated as a specific dollar amount.

(2) *Instructions for use.*

(a) Replace the first sentence in paragraph 1, Payment of Annuity Amount, of the sample trust with the following sentence:

In each taxable year of the trust during the annuity period, the Trustee shall pay to [*designated charitable recipient*] an annuity amount equal to [*the stated dollar amount*].

(b) Delete the last sentence in paragraph 1, Payment of Annuity Amount, of the sample trust concerning the incorrect valuation of trust assets.

.04 *Designation of an Alternate Charitable Beneficiary in the Trust Instrument.*

(1) *Explanation.* The sample trust provides that in the event the charitable beneficiary designated in the trust instrument is not an organization described in §§ 170(c) and 2055(a) at the time any payment is to be made to it, the trustee shall distribute such payments to one or more organizations described in §§ 170(c) and 2055(a) as the trustee shall select. As an alternative, the trust instrument may specifically designate one or more alternate charitable beneficiaries.

(2) *Instruction for use.* Replace the second sentence in paragraph 1, Payment of Annuity Amount, of the sample trust with the following two sentences:

If [*designated charitable recipient*] is not an organization described in §§ 170(c) and 2055(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to [*designated substitute charitable recipient*]. If neither [*designated charitable recipient*] nor [*designated substitute charitable recipient*] is an organization described in §§ 170(c) and 2055(a) at the time any payment is to be made to it, the Trustee shall instead distribute such payments to one or more organizations described in §§ 170(c) and 2055(a) as the Trustee shall select, and in such proportions as the Trustee shall decide, from time to time, in the Trustee's sole discretion.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephanie N. Bland of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Stephanie N. Bland at (202) 622–3090 or (202) 622–7830 (not a toll-free call).

26 CFR 1.141–3: Definition of private business use. (Also: §§ 103, 141,145; 1.141–3, 1.145–2.)

Rev. Proc. 2007–47

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth conditions under which a research agreement does not result in private business use under § 141(b) of the Internal Revenue Code of 1986 (the Code). This revenue procedure also addresses whether a research agreement causes the modified private business use test in § 145(a)(2)(B) of the Code to be met for qualified 501(c)(3) bonds. This revenue procedure modifies and supersedes Rev. Proc. 97–14, 1997–1 C.B. 634.

SECTION 2. BACKGROUND

.01 *Private Business Use.*

(1) Under § 103(a) of the Code, gross income does not include interest on any State or local bond. Under § 103(b)(1), however, § 103(a) does not apply to a private activity bond, unless it is a qualified bond under § 141(e). Section 141(a)(1) defines "private activity bond" as any bond issued as part of an issue that meets both the private business use and the private security or payment tests. Under § 141(b)(1), an issue generally meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Under § 141(b)(6)(A), private business use means direct or indirect use in a trade or business carried on by any person other than a governmental unit. Section 150(a)(2) provides that the term "governmental unit" does not include the United States or any agency or instrumentality thereof. Section 145(a) also applies the private business use test of § 141(b)(1) to qualified 501(c)(3) bonds, with certain modifications.

(2) Section 1.141–3(b)(1) of the Income Tax Regulations provides that both actual and beneficial use by a nongovernmental person may be treated as private business use. In most cases, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. In general, a nongovernmental person is treated as a private business user of proceeds and financed property as a result of ownership; actual or beneficial use of property pursuant to a lease, or a management or incentive payment contract; or certain other arrangements such as a take or pay or other output-type contract.

(3) Section 1.141–3(b)(6)(i) provides generally that an agreement by a nongovernmental person to sponsor research performed by a governmental person may result in private business use of the property used for the research, based on all the facts and circumstances.

(4) Section 1.141–3(b)(6)(ii) provides generally that a research agreement with respect to financed property results in private business use of that property if the sponsor is treated as the lessee or owner of financed property for Federal income tax purposes.

(5) Section 1.141–1(b) provides that the term "governmental person" means a State or local governmental unit as defined in § 1.103–1 or any instrumentality thereof. Section 1.141–1(b) further provides that governmental person does not include the United States or any agency or instrumentality thereof. Section 1.141–1(b) further provides that "nongovernmental person" means a person other than a governmental person.

(6) Section 1.145–2 provides that §§ 1.141–0 through 1.141–15 apply to qualified 501(c)(3) bonds under § 145(a) of the Code with certain modifications and exceptions.

(7) Section 1.145–2(b)(1) provides that, in applying §§ 1.141–0 through 1.141–15 to § 145(a) of the Code, references to governmental persons include § 501(c)(3) organizations with respect to their activities that do not constitute unrelated trades or businesses under § 513(a).

.02 *Federal Government rights under the Bayh-Dole Act.*

(1) The Patent and Trademark Law Amendments Act of 1980, as amended, 35 U.S.C. § 200 *et seq.* (2006) (the "Bayh-Dole Act"), generally applies to any contract, grant, or cooperative agreement with any Federal agency for the performance of research funded by the Federal Government.

(2) The policies and objectives of the Bayh-Dole Act include promoting the utilization of inventions arising from federally supported research and development programs, encouraging maximum participation of small business firms in federally supported research and development efforts, promoting collaboration between commercial concerns and nonprofit organizations, ensuring that inventions made by nonprofit organizations and small business firms are used in a manner to promote free competition and enterprise, and promoting the commercialization and public availability of inventions made in the United States by United States industry and labor.

(3) Under the Bayh-Dole Act, the Federal Government and sponsoring Federal agencies receive certain rights to inventions that result from federally funded research activities performed by non-sponsoring parties pursuant to contracts, grants, or cooperative research agreements with the sponsoring Federal agencies. The rights granted to the Federal Government and its agencies under the Bayh-Dole Act generally include, among others, nonexclusive, nontransferable, irrevocable, paid-up licenses to use the products of federally sponsored research and certain so-called "march-in rights" over licensing under limited circumstances. Here, the term "march-in rights" refers to certain rights granted to the sponsoring Federal agencies under the Bayh-Dole Act, 35 U.S.C. § 203 (2006), to take certain actions, including granting licenses to third parties to ensure public benefits from the dissemination and use of the results of federally sponsored research in circumstances in which the original contractor or assignee has not taken, or is not expected to take within a reasonable time, effective steps to achieve practical application of the product of that research. The general purpose of these rights is to ensure the expenditure of Federal research funds in accordance with the policies and objectives of the Bayh-Dole Act.

SECTION 3. DEFINITIONS

.01 *Basic research*, for purposes of § 141 of the Code, means any original investigation for the advancement of scientific knowledge not having a specific commercial objective. For example, product testing supporting the trade or business of a specific nongovernmental person is not treated as basic research.

.02 *Qualified user* means any State or local governmental unit as defined in § 1.103–1 or any instrumentality thereof. The term also includes a § 501(c)(3) organization if the financed property is not used in an unrelated trade or business under § 513(a) of the Code. The term does not include the United States or any agency or instrumentality thereof.

.03 *Sponsor* means any person, other than a qualified user, that supports or sponsors research under a contract.

SECTION 4. CHANGES

This revenue procedure modifies and supersedes Rev. Proc. 97–14 by making changes that are described generally as follows:

.01 Section 6.03 of this revenue procedure modifies the operating guidelines on cooperative research agreements to include agreements regarding industry or federally sponsored research with either a single sponsor or multiple sponsors.

.02 Section 6.04 of this revenue procedure provides special rules for applying the revised operating guidelines under section 6.03 of this revenue procedure to federally sponsored research. These special rules provide that the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause research agreements to fail to meet the requirements of section 6.03, upon satisfaction of the requirements of section 6.04 of this revenue procedure. Thus, under the stated conditions, such rights themselves will not result in private business use by the Federal Government or its agencies of property used in research performed under research agreements. These special rules do not address the use by third parties that actually receive more than non-exclusive, royalty-free licenses as the result of the exercise by a sponsoring Federal agency of its rights under the Bayh-Dole Act, such as its march-in rights.

SECTION 5. SCOPE

This revenue procedure applies when, under a research agreement, a sponsor uses property financed with proceeds of an issue of State or local bonds subject to § 141 or § 145(a)(2)(B) of the Code.

SECTION 6. OPERATING GUIDELINES FOR RESEARCH AGREEMENTS

.01 *In general.* If a research agreement is described in either section 6.02 or 6.03 of this revenue procedure, the research agreement itself does not result in private business use. In applying the operating guidelines under section 6.03 of this revenue procedure to federally sponsored research, the special rules under section 6.04 of this revenue procedure (regarding the effect of the rights of the Federal Government and its agencies under the Bayh-Dole Act) apply.

.02 *Corporate-sponsored research.* A research agreement relating to property used for basic research supported or sponsored by a sponsor is described in this section 6.02 if any license or other use of resulting technology by the sponsor is permitted only on the same terms as the recipient would permit that use by any unrelated, non-sponsoring party (that is, the sponsor must pay a competitive price for its use), and the price paid for that use must be determined at the time the license or other resulting technology is available for use. Although the recipient need not permit persons other than the sponsor to use any license or other resulting technology, the price paid by the sponsor must be no less than the price that would be paid by any non-sponsoring party for those same rights.

.03 *Industry or federally-sponsored research agreements.* A research agreement relating to property used pursuant to an industry or federally-sponsored research arrangement is described in this section 6.03 if the following requirements are met, taking into account the special rules set forth in section 6.04 of this revenue procedure in the case of federally sponsored research —

(1) A single sponsor agrees, or multiple sponsors agree, to fund governmentally performed basic research;

(2) The qualified user determines the research to be performed and the manner in which it is to be performed (for example, selection of the personnel to perform the research);

(3) Title to any patent or other product incidentally resulting from the basic research lies exclusively with the qualified user; and

(4) The sponsor or sponsors are entitled to no more than a nonexclusive, royalty-free license to use the product of any of that research.

.04 *Federal Government rights under the Bayh-Dole Act.* In applying the operating guidelines on industry and federally-sponsored research agreements under section 6.03 of this revenue procedure to federally sponsored research, the rights of the Federal Government and its agencies mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03, provided that the requirements of sections 6.03(2), and (3) are met, and the license granted to any party other than the qualified user to use the product of the research is no more than a nonexclusive, royalty-free license. Thus, to illustrate, the existence of march-in rights or other special rights of the Federal Government or the sponsoring Federal agency mandated by the Bayh-Dole Act will not cause a research agreement to fail to meet the requirements of section 6.03 of this revenue procedure, provided that the qualified user determines the subject and manner of the research in accordance with section 6.03(2), the qualified user retains exclusive title to any patent or other product of the research in accordance with section 6.03(3), and the nature of any license granted to the Federal Government or the sponsoring Federal agency (or to any third party nongovernmental person) to use the product of the research is no more than a nonexclusive, royalty-free license.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97–14 is modified and superseded.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for any research agreement entered into, materially modified, or extended on or after June 26, 2007. In addition, an issuer may apply this revenue procedure to any research agreement entered into prior to June 26, 2007.

SECTION 9. DRAFTING INFORMATION

The principal authors of this revenue procedure are Vicky Tsilas and Johanna Som de Cerff of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Johanna Som de Cerff at (202) 622–3980 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 167, 168, 446, 481; 1.446–1, 1.481–1.)

Rev. Proc. 2007–48

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting to treat rotable spare parts as depreciable assets in accordance with Rev. Rul. 2003–37, 2003–1 C.B. 717, and provides procedures for taxpayers to obtain the automatic consent of the Commissioner of Internal Revenue to change to the safe harbor method of accounting.

SECTION 2. BACKGROUND

.01 In both *Hewlett-Packard Co.. v. United States*, 71 F.3d 398 (Fed. Cir. 1995), *rev'g Apollo Computer, Inc. v. United States*, 32 Fed. Cl. 334 (1994), and *Honeywell, Inc. v. Commissioner*, T.C. Memo. 1992–453, *aff'd per curiam*, 27 F.3d 571 (8^{th} Cir. 1994), the courts held that the taxpayers properly treated their pools of rotable spare parts as depreciable assets, rather than as inventory. The taxpayers in *Hewlett-Packard* and *Honeywell* were engaged in the trade or business of manufacturing computers and computer parts, and also in the business of repairing and servicing computers purchased or leased by their customers. Most of the taxpayers' computer maintenance operations were conducted pursuant to standardized maintenance agreements that obligated the taxpayers to provide all parts and labor, product upgrades, preventive maintenance, and telephone assistance necessary to keep a customer's computer operational for the duration of the contract (usually one year) in exchange for a predetermined fee. In conducting their computer maintenance operations, the taxpayers sent repair technicians to a customer's location to diagnose and repair the customer's computer. The taxpayers' repair technicians used a supply of rotable spare parts to diagnose problems in a customer's equipment, and then would exchange a working part for any malfunctioning part. The malfunctioning part removed from the customer's equipment would then be repaired and placed in the taxpayers' rotable spare parts pools for continued use in the maintenance operation. The taxpayers followed this practice of exchanging their rotable spare parts for malfunctioning parts in a customer's computer to avoid rendering a customer's computer inoperative while the original part was being repaired.

The parts in the taxpayers' rotable spare parts pools were obtained from the taxpayers' manufacturing facilities. However, the taxpayers operated their computer maintenance operations separate from their manufacturing operations and at all times the rotable spare parts were physically segregated from the taxpayers' regular manufacturing inventories.

.02 In Rev. Rul. 2003–37, the Internal Revenue Service announced that it will follow the judgments in *Hewlett-Packard* and *Honeywell*, and that a taxpayer may treat rotable spare parts as depreciable assets, provided the taxpayer's facts are substantially similar to the facts in those cases.

.03 The Service and Department of the Treasury are aware that the treatment of rotable spare parts as depreciable assets has continued to be the subject of controversy in situations when a taxpayer, as part of its maintenance operations, sells rotable spare parts from the taxpayer's pool of rotable spare parts that are treated as depreciable assets. For reasons of administrative convenience, and to reduce further controversy, if a taxpayer within the scope of this revenue procedure maintains one or more pools of rotable spare parts that it treats as depreciable assets and sells rotable spare parts from these pools, the Service will not challenge the taxpayer's treatment of the pools of rotable spare parts as depreciable assets for a particular taxable year if, for that year, the taxpayer uses the method of accounting provided in section 4 of this revenue procedure.

.04 Section 167(a) of the Internal Revenue Code provides a depreciation allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business. The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. Depreciation allowances under § 168 are determined using either: (1) the general depreciation system (GDS) in § 168(a); or (2) the alternative depreciation system (ADS) in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention. For purposes of either GDS or ADS, the applicable recovery period is determined by reference to class life or by statute.

.05 Rev. Proc. 87–56, 1987–2 C.B. 674, as clarified and modified by Rev. Proc. 88–22, 1988–1 C.B. 785, sets forth the class lives of depreciable tangible property that are necessary to determine the recovery period of that property under § 168. The revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business activities.

.06 Pursuant to § 167(c), the basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property generally is the adjusted basis provided in § 1011 for the purpose of determining the gain on the sale or other disposition of such property. See also § 1.168(b)–1(a)(3) and (a)(4) of the Income Tax Regulations for the definitions of unadjusted depreciable basis and adjusted depreciable basis, respectively, for purposes of § 168.

.07 Under § 446(b), the Commissioner has broad authority to determine whether a method of accounting clearly reflects income. Section 1.446–1(c)(2)(ii) provides that the Commissioner may authorize a taxpayer to adopt or change to a permissible method of accounting although the method is not specifically permitted if, in the opinion of the Commissioner, that method clearly reflects income.

.08 Section 446(e) and § 1.446–1(e)(2)(i) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to obtain the Commissioner's consent to effect the change in method of accounting and to prevent amounts from being duplicated or omitted. The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a § 481(a) adjustment or on a cut-off basis, and the § 481(a) adjustment period.

.09 Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432), provides procedures by which a taxpayer may obtain automatic consent to change to a method of accounting described in the Appendix of Rev. Proc. 2002–9.

.10 Section 481(a) requires adjustments necessary to prevent amounts from being duplicated or omitted by reason of a change in method of accounting.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that —

(1) repairs customer-owned (or customer-leased) equipment under warranty or maintenance agreements that are provided to the customer for either no charge or a predetermined fee that does not change during the term of the agreement (regardless of the taxpayer's costs to comply with the agreement);

(2) is obligated under the warranty or maintenance agreements to repair the customer's equipment (including all parts and labor related to the repair) for either no charge or a nominal service fee that is unrelated to the actual cost of parts and labor provided;

(3) maintains a pool or pools of spare parts that are used primarily in the taxpayer's maintenance operation of repairing customer-owned (or customer-leased) equipment under warranty or maintenance agreements, exchanges the spare parts for defective parts in the customer-owned (or customer-leased) equipment, and generally repairs and reuses the defective parts in its pool of spare parts (the "rotable spare parts"); and

(4) has a depreciable interest in the rotable spare parts and has placed in service the rotable spare parts after 1986.

SECTION 4. SAFE HARBOR METHOD OF ACCOUNTING FOR ROTABLE SPARE PARTS

.01 *In General.* This section 4 describes a safe harbor method of accounting for rotable spare parts. A taxpayer is eligible to use the safe harbor method of accounting in any taxable year in which the taxpayer —

(a) is within the scope of section 3 of this revenue procedure; and

(b) has gross sales (less returns) of rotable spare parts from the taxpayer's maintenance operation that do not exceed 10 percent of the taxpayer's total gross revenues (less returns) from its maintenance operation for the taxable year.

.02 *Description of Safe Harbor Method of Accounting.* A taxpayer using the safe harbor method of accounting for rotable spare parts must —

(1) capitalize the cost of the rotable spare parts under § 263(a) and depreciate these parts under § 168 in accordance with section 4.03 of this revenue procedure;

(2) establish one or more pools for the rotable spare parts in accordance with section 4.04 of this revenue procedure;

(3) identify the disposed rotable spare parts in accordance with section 4.05 of this revenue procedure; and

(4) determine the depreciable basis of the rotable spare parts for depreciation purposes in accordance with § 167(c), § 1011, and § 1.168(b)–1(a)(3) and (a)(4).

.03 *Depreciation Allowable.*

(1) *In general.* For purposes of determining the depreciation allowable for the rotable spare parts under the safe harbor method of accounting described in section 4.02 of this revenue procedure, the applicable depreciation method for the rotable spare parts is determined under § 168(b)(1) or (2), as applicable, unless either (a) the taxpayer made a timely valid election under § 168(b)(5) to use the straight line method of depreciation for the class of property (as set forth in § 168(e)) in which the rotable spare parts are included, or (b) the rotable spare parts are required to be depreciated under the alternative depreciation system in § 168(g). Rotable spare parts required to be depreciated under the alternative depreciation system include rotable spare parts in a class of property (as set forth in § 168(e)) for which the taxpayer made a timely valid election under § 168(g)(7). In addition, the applicable recovery period for the rotable spare parts is determined under § 168(c) or 168(g), as applicable, by including the rotable spare parts in the following asset class of Rev. Proc. 87–56:

(a) the asset class in Rev. Proc. 87–56 applicable to the taxpayer's manufacturing activity if the taxpayer, under warranty or maintenance agreements, repairs only customer-owned (or customer-leased) equipment that is manufactured only by the taxpayer; or

(b) asset class 57.0, *Distributive Trades or Services*, if: (i) the taxpayer, under warranty or maintenance agreements, repairs both customer-owned (or customer-leased) equipment that is manufactured by the taxpayer and customer-owned (or customer-leased) equipment that is manufactured by others; (ii) the taxpayer is not a manufacturer of the type of customer-owned (or customer-leased) equipment that is being repaired; or (iii) the taxpayer (including a taxpayer described in section 4.03(1)(a) of this revenue procedure) charges the customer a nominal service fee (that is unrelated to the actual cost of parts and labor provided) to repair customer-owned (or customer-leased) equipment under warranty or maintenance agreements.

(2) *Additional first year depreciation deduction.* In determining the amount of the § 481(a) adjustment as described in section 5.04 of this revenue procedure, the additional first year depreciation deduction allowable under § 168(k), 1400L(b), or 1400N(d) is taken into account for any qualifying rotable spare part. However, the deemed placed-in-service date referred to in section 5.04(2)(b) of this revenue procedure for the rotable spare part is not the acquisition date of the rotable spare part for purposes of the acquisition date requirement in § 168(k), 1400L(b), or 1400N(d).

.04 *Establishment of Pools.*

(1) *In general.* Under the safe harbor method of accounting described in section 4.02 of this revenue procedure, a taxpayer must establish one or more pools for the rotable spare parts. Each pool must include only the rotable spare parts that are placed in service by the taxpayer in the same taxable year and have the same: (a) asset class under Rev. Proc. 87–56, (b) applicable depreciation method, (c) applicable recovery period, and (d) applicable convention. Additionally, rotable spare parts subject to the mid-quarter convention may only be grouped into a pool with rotable spare parts that are placed in service in the same quarter of the taxable year.

(2) *General asset account election.* If a taxpayer within the scope of this revenue procedure is changing the treatment of its rotable spare parts to the safe harbor method of accounting described in section 4.02 of this revenue procedure, the taxpayer also may elect to establish general asset accounts for the rotable spare parts beginning in the year of change, provided the terms and conditions in section 5.02(5) of this revenue procedure are satisfied beginning in the year of change.

.05 *Dispositions.*

(1) *In general.* Under the safe harbor method of accounting described in section 4.02 of this revenue procedure, a taxpayer must use a method of accounting provided in this section 4.05 for identifying the disposed rotable spare parts. Any method other than one provided in this section 4.05 (including the "net additions" method) is not a permissible method of accounting for dispositions.

(2) *Permissible methods of identifying disposed rotable spare parts.* For purposes of the safe harbor method of accounting described in section 4.02 of this revenue procedure, a taxpayer must use one of the following methods of accounting to identify its disposed rotable spare parts:

(a) Specific identification of each disposed rotable spare part; or

(b) A first-in, first-out method of accounting if, in the case of rotable spare parts that are mass assets, the total rotable spare parts dispositions during a particular taxable year are readily determined from a taxpayer's records but it is impracticable for the taxpayer to maintain records from which the taxpayer can determine the particular taxable year in which the disposed rotable spare parts were placed in service by the taxpayer. A taxpayer using the first-in, first-out method of accounting under this section 4.05(2)(b) must identify the rotable spare parts disposed of in a taxable year from the pool with the earliest placed-in-service year existing at the beginning of the taxable year of the disposition. For purposes of this paragraph, mass assets are a mass or group of individual items of depreciable property —

(i) that are not necessarily homogeneous;

(ii) each of which is minor in value relative to the total value of the mass or group;

(iii) numerous in quantity;

(iv) usually accounted for only on a total dollar or quantity basis;

(v) with respect to which separate identification is impracticable; and,

(vi) that are placed in service by the taxpayer in the same taxable year.

SECTION 5. CHANGES IN METHOD OF ACCOUNTING

.01 *In General.* Any change in a taxpayer's treatment of rotable spare parts pursuant to this revenue procedure is a change in method of accounting to which § 446 and (except as otherwise provided in this section 5) § 481, and the regulations thereunder, apply. This section 5 applies to a taxpayer within the scope of this revenue procedure that —

(1) currently does not capitalize and depreciate the cost of its rotable spare parts and wants to change to the safe harbor method of accounting described in section 4.02 of this revenue procedure;

(2) currently treats its rotable spare parts in accordance with sections 4.02(1), (3), and (4) of this revenue procedure and wants to establish rotable spare parts pools in accordance with section 4.04(1) of this revenue procedure;

(3) currently treats its rotable spare parts in accordance with sections 4.02(1), (2), and (4) of this revenue procedure and wants to change to a method of accounting described in section 4.05(2) of this revenue procedure for identifying the disposed rotable spare parts; or

(4) currently treats its rotable spare parts in accordance with sections 4.02(1) and (4) of this revenue procedure and wants to establish rotable spare parts pools in accordance with section 4.04(1) of this revenue procedure and change to a method of accounting described in section 4.05(2) of this revenue procedure for identifying the disposed rotable spare parts.

.02 *Automatic Change.* A taxpayer within the scope of this revenue procedure is granted the consent of the Commissioner to make a change in method of accounting described in section 5.01 of this revenue procedure provided that the taxpayer follows the automatic change in method of accounting provisions in Rev. Proc. 2002–9 (or any successor), with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to make the change in method of accounting for its first or second taxable year ending on or after December 31, 2006, provided the taxpayer's method of accounting for rotable spare parts is not an issue under consideration for taxable years under examination, within the meaning of section 3.09 of Rev. Proc. 2002–9, at the time the Form 3115, *Application for Change in Accounting Method,* is filed with the national office.

(2) For purposes of completing line 1a of Form 3115, the designated automatic accounting method change number for the changes in method of accounting provided in section 5.01 of this revenue procedure is No. 109.

(3) The taxpayer must compute any applicable § 481(a) adjustment in accordance with section 5.04 of this revenue procedure.

(4) The taxpayer must own the rotable spare parts as of the beginning of the year of change and must determine the adjusted depreciable basis of the rotable spare parts as of the beginning of the year of change in accordance with § 167(c), § 1011(a), and § 1.168(b)–1(a)(3) and (a)(4). The reductions required by § 1016(a)(2) for the depreciation allowable for the rotable spare parts must be determined under the method of accounting for depreciation allowable under section 4.03 of this revenue procedure for all open and closed taxable years prior to the year of change.

(5) If a taxpayer described in section 4.04(2) of this revenue procedure elects to establish general asset accounts for the rotable spare parts, the taxpayer must meet all of the following requirements beginning in the year of change:

(a) The taxpayer must consent to, and agree to apply, all of the provisions of § 1.168(i)–1 to the rotable spare parts included in the general asset accounts, beginning with the year of change. Thus, pursuant to § 1.168(i)–1(k)(1), the establishment of general asset accounts beginning with the year of change is irrevocable and will be binding on the taxpayer for computing taxable income for the year of change and for all subsequent taxable years, except as provided in § 1.168(i)–1(c)(1)(ii)(A), (e)(3), (g), or (h)(1).

(b) The taxpayer must use a method of accounting described in section 4.05(2) of this revenue procedure for identifying the disposed rotable spare parts for purposes of applying § 1.168(i)–1(i).

(c) The taxpayer must group the rotable spare parts into one or more general asset accounts in accordance with the rules in § 1.168(i)–1(c) and each general asset account must include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account. The beginning balance for the unadjusted depreciable basis of each general asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all rotable spare parts included in that general asset account. The beginning balance of the depreciation reserve of each general asset account is equal to the portion of the accumulated depreciation component of the net § 481(a) adjustment that is allocable to the rotable spare parts included in that general asset account.

.03 *Changes Made on a Cut-off Method.* A taxpayer making a change in method of accounting described in section 5.01(2), (3), or (4) of this revenue procedure must make the change on a cut-off method. Thus, the new method of accounting applies to rotable spare parts placed in service, or disposed of, by the taxpayer beginning in the year of change.

.04 *Changes Made Using a § 481(a) Adjustment.*

(1) *In general.* A taxpayer making a change in method of accounting under section 5.01(1) of this revenue procedure to the safe harbor method of accounting must make the change using a § 481(a) adjustment. As required by the Form 3115, the taxpayer must attach a summary of the computation and an explanation of the methodology used to determine the § 481(a) adjustment. To use the safe harbor method of accounting, the taxpayer also must include in the required attachment the amount of the taxpayer's total gross sales (less returns) of rotable spare parts and gross revenues (less returns) from the taxpayer's maintenance operation for the year of change and every year of the qualifying period used to compute the § 481(a) adjustment.

(2) *Computation of § 481(a) Adjustment.*

(a) In computing the § 481(a) adjustment, the taxpayer must use the adjusted depreciable basis of the rotable spare parts computed under the safe harbor method, as of the first day of the year of change taking into account the placed-in-service date provided for in subparagraph (2)(b) of this section 5.04 and the qualifying period described in subparagraph (3) of this section 5.04.

(b) Any rotable spare parts that were: (i) placed in service by the taxpayer after 1986 and in a taxable year prior to the earliest taxable year of the qualifying period, and (ii) owned by the taxpayer as of the beginning of the earliest taxable year of the qualifying period, must be treated as placed in service by the taxpayer in the earliest taxable year of the qualifying period. A taxpayer that does not have the books and records to determine whether it meets the requirements of section 4.01 of this revenue procedure in every year in which the rotable spare parts on hand as of the beginning of the year of change were placed in service and in every subsequent year prior to the year of change, must compute the § 481(a) adjustment using a qualifying period that can be established based on its books and records.

(3) *Qualifying period.* For purposes of this section 5.04, a "qualifying period" consists of the taxable year, or consecutive taxable years, immediately preceding the year of change during which the taxpayer can establish that it meets the requirements of section 4.01 of this revenue procedure.

.05 *Nonautomatic Changes.* If a taxpayer is not eligible to change to the safe harbor method of accounting provided in this revenue procedure, the taxpayer may request to change its method of accounting for treating rotable spare parts by filing a Form 3115 with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27, 1997–1 C.B. 680 (as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified and clarified by Rev. Proc. 2002–54, 2002–2 C.B. 432).

.06 *Requirement to Change From the Safe Harbor Method.* A taxpayer that changes to the safe harbor method under this revenue procedure and subsequently fails to meet the requirements of section 4.01 of this revenue procedure must change its method of accounting for rotable spare parts to an appropriate inventory method of accounting for the first taxable year in which the taxpayer becomes ineligible to use the safe harbor method of accounting for rotable spare parts. A taxpayer that is required to change its method of accounting under this section 5.06 must file a Form 3115 in accordance with the automatic change in method of accounting provisions of Rev. Proc. 2002–9 (or any successor), with the following modifications:

(1) the scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply; and

(2) the designated automatic accounting method change number for changes in method of accounting from the safe harbor method of accounting made pursuant to this section 5.06 is No. 110.

SECTION 6. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2002–9 is modified and amplified to include the accounting method changes described in this revenue procedure in section 3 of the APPENDIX.

.02 Section 2.01(1)(d)(xiii)(A) of the APPENDIX of Rev. Proc. 2002–9 (as modified by Rev. Proc. 2004–11, 2004–1 C.B. 311) is modified to read as follows:

(A) a change in inventory costs (for example, when property is reclassified from inventory property to depreciable property, or vice versa) (but see section 3.02 of this APPENDIX for making a change in method of accounting from inventory property to depreciable property for unrecoverable line pack gas or unrecoverable cushion gas, and Rev. Proc. 2007–48, 2007–29 I.R.B. 110, for making a change in method of accounting from inventory property to depreciable property for rotable spare parts);

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2006. The Service will not challenge a taxpayer's use of the safe harbor method of accounting described in section 4.02 of this revenue procedure in an earlier taxable year if the taxpayer, for that taxable year, meets the requirements of section 4.01 of this revenue procedure. Moreover, if a taxpayer currently uses the safe harbor method of accounting described in section 4.02 of this revenue procedure and the use of such method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) in examination, before an appeals office, or before the U.S. Tax Court and the taxpayer meets the requirements of section 4.01 of this revenue procedure for the taxable years under examination, before an appeals office, or before the U.S. Tax Court, the issue will not be further pursued.

SECTION 8. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–2070. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 5.04(1). This information is required to determine whether the taxpayer qualifies to use the safe harbor method of accounting. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions. The estimated total annual reporting and/or recordkeeping burden is 75 hours. The estimated annual frequency of responses is 300.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Gwen Turner of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Turner at (202) 622–5020 (not a toll-free call). For further information regarding the method of computing depreciation for rotable spare parts, the establishment of pools or general asset accounts for rotable spare parts, or the method of identifying the disposed rotable spare parts, contact Douglas Kim of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622–4930 (not a toll-free call).

Part IV. Items of General Interest

Proposed Form 1118, Foreign Tax Credit — Corporations

Announcement 2007–62

The Internal Revenue Service (IRS) announces that it is requesting comments from the public on proposed revisions to Form 1118, *"Foreign Tax Credit — Corporations."* This Form is used by U.S. corporate taxpayers to compute the foreign tax credit for certain taxes paid or accrued to foreign countries or U.S. possessions. Form 1118 is being revised as a result of amendments to section 904 of the Internal Revenue Code (Code) relating to the number of separate foreign tax credit limitation categories and the effect of overall domestic losses. Attached to this announcement is a copy of the proposed form, with respect to which the IRS is requesting comments from the public. The proposed revisions have also been posted on the IRS website, at *http://www.irs.gov/taxpros/lists/0,,id=97782,00.html.*

BACKGROUND

Section 404 of the American Jobs Creation Act of 2004, Public Law 108–357, 118 Stat. 1418 (October 22, 2004) (AJCA) generally reduced the number of separate categories under section 904(d) from eight to two, effective for tax years beginning after December 31, 2006. This provision does not, however, affect the separate computation of foreign tax credit limitations under special provisions of the Code relating to, for example, treaty-based sourcing rules or specified countries under section 901(j).

Section 402(a) of the AJCA added new section 904(g), which provides for the recharacterization of U.S. source income as foreign source income in cases in which a taxpayer's foreign tax credit limitation has been reduced in an earlier year as a result of an overall domestic loss. The new section 904(g) provides parity in the treatment of overall foreign losses and overall domestic losses in order to mitigate the double taxation of foreign source income.

PROPOSED REVISIONS TO FORM 1118

Form 1118 has generally been revised to eliminate information reporting regarding section 904(d) separate categories that have been eliminated by the AJCA. In addition, several other revisions have been made to the Form to reflect the overall domestic loss provisions of new section 904(g). For example, a new column has been added to Schedule A to more clearly reflect deductions for NOL carryovers and several other specific revisions have been made to Schedule J.

A new column has been added to Schedule J for U.S. source income or loss. This column is intended to be helpful in determining U.S. income subject to recharacterization from the recapture of overall domestic losses and otherwise tracking the balances of overall domestic losses.

In Part I, the step for allocating current year U.S. source losses on line 10 of the current Schedule J is moved to line 5 and renamed "allocation of domestic losses." Placing this step before the recapture of overall foreign losses is a departure from the ordering rules set forth in Notice 89–3, 1989–1 C.B. 623. A new step has also been added to Part I on line 10 for the recapture of overall domestic losses now required under the new section 904(g). The instructions to Schedule J will clarify that the recapture amount is determined based on the U.S. income subtotal from line 6, which does not take into account the effect of any recapture of overall foreign losses.

A new Part IV has been added to Schedule J to track additions and reductions to overall domestic loss account balances that are needed in applying the provisions of new section 904(g).

REQUEST FOR PUBLIC COMMENT

The IRS requests comments on the proposed revisions to the current Form 1118. The IRS is particularly interested in receiving comments on the ordering rules as reflected on the proposed Schedule J. Such comments will be useful in the drafting of proposed regulations under section 904(f) and (g), which will include detailed ordering rules as well as other guidance under these provisions.

Written comments should be sent to: Tax Products Coordinating Committee, Internal Revenue Service, SE:W:CAR:MP:T, Room 6406, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Alternatively, comments may be e-mailed to *tfpmail@publish.no.irs.gov*. Comments must be received by September 10, 2007.

The principal author of this announcement is Jeffrey L. Parry of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this announcement, contact Jeffrey L. Parry at (202) 622–3850 (not a toll-free call).

Form **1118** (Rev. December 2007)
Department of the Treasury
Internal Revenue Service

Foreign Tax Credit—Corporations

▶ **Attach to the corporation's tax return.**
▶ **See separate instructions.**

For calendar year 20 , or other tax year beginning , 20 , and ending , 20

OMB No. 1545-0122

Name of corporation | **Employer identification number**

Use a **separate** Form 1118 for each applicable category of income listed below. See **Categories of Income** on page 1 of instructions. Also, see **Specific Instructions** on page 5. Check only one box on each form.

☐ Passive Category Income ☐ Section 901(j) Income: Name of Sanctioned Country ▶ ____________
☐ General Category Income ☐ Income Re-sourced by Treaty: Name of Country ▶ ____________

Schedule A Income or (Loss) Before Adjustments *(Report all amounts in U.S. dollars. See page 5 of instructions.)*

	1. Foreign Country or U.S. Possession (Enter two-letter code from list beginning on page 11 of instructions. Use a separate line for each.)*	Gross Income or (Loss) From Sources Outside the United States (*INCLUDE* Foreign Branch Gross Income here *and* on Schedule F)								
		2. Deemed Dividends (see instructions)		**3.** Other Dividends		**4.** Interest	**5.** Gross Rents, Royalties, and License Fees	**6.** Gross Income From Performance of Services	**7.** Other (attach schedule)	**8.** Total (add columns 2(a) through 7)
		(a) Exclude gross-up	**(b)** Gross-up (sec. 78)	**(a)** Exclude gross-up	**(b)** Gross-up (sec. 78)					
A										
B										
C										
D										
E										
F										
Totals (add lines A through F)										

* For section 863(b) income, use a single line and enter "863(b)."

	Deductions (*INCLUDE* Foreign Branch Deductions here *and* on Schedule F)								**13.** Total Income or (Loss) Before Adjustments (subtract column 12 from column 8)
	9. Definitely Allocable Deductions					**10.** Apportioned Share of Deductions Not Definitely Allocable (enter amount from applicable line of Schedule H, Part II, column (d))	**11.** Net Operating Loss Deduction	**12.** Total Deductions (add columns 9(e) through 11)	
	Rental, Royalty, and Licensing Expenses		**(c)** Expenses Related to Gross Income From Performance of Services	**(d)** Other Definitely Allocable Deductions	**(e)** Total Definitely Allocable Deductions (add columns 9(a) through 9(d))				
	(a) Depreciation, Depletion, and Amortization	**(b)** Other Expenses							
A									
B									
C									
D									
E									
F									
Totals									

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 10900F Form **1118** (Rev. 12-2007)

Schedule B Foreign Tax Credit *(Report all foreign tax amounts in U.S. dollars.)*

Part I—Foreign Taxes Paid, Accrued, and Deemed Paid *(see page 5 of instructions)*

	1. Credit is Claimed for Taxes: ☐ Paid ☐ Accrued		2. Foreign Taxes Paid or Accrued (attach schedule showing amounts in foreign currency and conversion rate(s) used)								3. Tax Deemed Paid (from Schedule C—Part I, column 10, Part II, column 8(b), and Part III, column 8)
			Tax Withheld at Source on:			Other Foreign Taxes Paid or Accrued on:					
	Date Paid	Date Accrued	**(a)** Dividends	**(b)** Interest	**(c)** Rents, Royalties, and License Fees	**(d)** Section 863(b) Income	**(e)** Foreign Branch Income	**(f)** Services Income	**(g)** Other	**(h)** Total Foreign Taxes Paid or Accrued (add columns 2(a) through 2(g))	
A											
B											
C											
D											
E											
F											
Totals (add lines A through F)											

Part II—Separate Foreign Tax Credit *(Complete a **separate** Part II for **each** applicable category of income.)*

1 Total foreign taxes paid or accrued (total from Part I, column 2(h))

2 Total taxes deemed paid (total from Part I, column 3).

3 Reductions of taxes paid, accrued, or deemed paid (enter total from Schedule G) ( )

4 Total carryover of foreign taxes (attach schedule showing computation in detail—see page 6 of the instructions).

5 Total foreign taxes (combine lines 1 through 4)

6 Enter the amount from the applicable column of Schedule J, Part I, line 11 (see page 6 of instructions). If Schedule J is **not** required to be completed, enter the result from the "Totals" line of column 12 of the applicable Schedule A

7a Total taxable income from all sources (enter taxable income from the corporation's tax return)

b Adjustments to line 7a (see page 6 of instructions).

c Subtract line 7b from line 7a

8 Divide line 6 by line 7c. Enter the resulting fraction as a decimal (see instructions). If line 6 is greater than line 7c, enter 1

9 Total U.S. income tax against which credit is allowed (regular tax liability (see section 26(b)) minus American Samoa Economic Development Credit)

10 Credit limitation (multiply line 8 by line 9) (see page 6 of instructions)

11 **Separate foreign tax credit** (enter the smaller of line 5 or line 10 here and on the appropriate line of Part III).

Part III—Summary of Separate Credits (Enter amounts from Part II, line 11 for **each** applicable category of income. **Do not** include taxes on taxable income attributable to foreign trade income or taxes paid to sanctioned countries.)

1 Credit for taxes on passive category income

2 Credit for taxes on general category income

3 Credit for taxes on income re-sourced by treaty (combine all such credits on this line).

4 Total (add lines 1 through 3)

5 Reduction in credit for international boycott operations (see page 6 of instructions).

6 **Total foreign tax credit** (subtract line 5 from line 4). Enter here and on the appropriate line of the corporation's tax return

Form **1118** (Rev. 12-2007)

Schedule C Tax Deemed Paid by Domestic Corporation Filing Return

Use this schedule to figure the tax deemed paid by the corporation with respect to dividends from a first-tier foreign corporation under section 902(a), and deemed inclusions of earnings from a first- or lower-tier foreign corporation under section 960(a). ***Report all amounts in U.S. dollars unless otherwise specified.***

Part I—Dividends and Deemed Inclusions From Post-1986 Undistributed Earnings

1. Name of Foreign Corporation (identify DISCs and former DISCs)	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated		7. Post-1986 Foreign Income Taxes (add columns 5, 6(a), and 6(b))	8. Dividends and Deemed Inclusions		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
					(a) Taxes Paid	(b) Taxes Deemed Paid (from Schedule D, Part I—see instructions)		(a) Functional Currency	(b) U.S. Dollars		

Total (Add amounts in column 10. Enter the result here and include on "Totals" line of Schedule B, Part I, column 3) . . . . ▶

Part II—Dividends Paid Out of Pre-1987 Accumulated Profits

1. Name of Foreign Corporation (identify DISCs and former DISCs)	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Accumulated Profits for Tax Year Indicated (in functional currency computed under section 902) (attach schedule)	5. Foreign Taxes Paid and Deemed Paid on Earnings and Profits (E&P) for Tax Year Indicated (in functional currency) (see instructions)	6. Dividends Paid		7. Divide Column 6(a) by Column 4	8. Tax Deemed Paid (see instructions)	
					(a) Functional Currency	(b) U.S. Dollars		(a) Functional Currency	(b) U.S. Dollars

Total (Add amounts in column 8b. Enter the result here and include on "Totals" line of Schedule B, Part I, column 3) . . . . ▶

Part III—Deemed Inclusions From Pre-1987 Earnings and Profits

1. Name of Foreign Corporation (identify DISCs and former DISCs)	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. E&P for Tax Year Indicated (in functional currency translated from U.S. dollars, computed under section 964) (attach schedule)	5. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated (see instructions)	6. Deemed Inclusions		7. Divide Column 6(a) by Column 4	8. Tax Deemed Paid (multiply column 5 by column 7)
					(a) Functional Currency	(b) U.S. Dollars		

Total (Add amounts in column 8. Enter the result here and include on "Totals" line of Schedule B, Part I, column 3) . . . . ▶

Form **1118** (Rev. 12-2007)

Schedule D Tax Deemed Paid by First- and Second-Tier Foreign Corporations under Section 902(b)

Use Part I to compute the tax deemed paid by a first-tier foreign corporation with respect to dividends from a second-tier foreign corporation. Use Part II to compute the tax deemed paid by a second-tier foreign corporation with respect to dividends from a third-tier foreign corporation. ***Report all amounts in U.S. dollars unless otherwise specified.***

Part I—Tax Deemed Paid by First-Tier Foreign Corporations

Section A—Dividends Paid Out of Post-1986 Undistributed Earnings (Include the column 10 results in Schedule C, Part I, column 6(b).)

1. Name of Second-Tier Foreign Corporation and Its Related First-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated		7. Post-1986 Foreign Income Taxes (add columns 5, 6(a), and 6(b))	8. Dividends Paid (in functional currency)		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
					(a) Taxes Paid	(b) Taxes Deemed Paid (see instructions)		(a) of Second-tier Corporation	(b) of First-tier Corporation		

Section B—Dividends Paid Out of Pre-1987 Accumulated Profits (Include the column 8(b) results in Schedule C, Part I, column 6(b).)

1. Name of Second-Tier Foreign Corporation and Its Related First-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Accumulated Profits for Tax Year Indicated (in functional currency—attach schedule)	5. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated (in functional currency—see instructions)	6. Dividends Paid (in functional currency)		7. Divide Column 6(a) by Column 4	8. Tax Deemed Paid (see instructions)	
					(a) of Second-tier Corporation	(b) of First-tier Corporation		(a) Functional Currency of Second-tier Corporation	(b) U.S. Dollars

Part II—Tax Deemed Paid by Second-Tier Foreign Corporations

Section A—Dividends Paid Out of Post-1986 Undistributed Earnings (Include the column 10 results in Section A, column 6(b), of Part I above.)

1. Name of Third-Tier Foreign Corporation and Its Related Second-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated		7. Post-1986 Foreign Income Taxes (add columns 5, 6(a), and 6(b))	8. Dividends Paid (in functional currency)		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
					(a) Taxes Paid	(b) Taxes Deemed Paid (from Schedule E, Part I, column 10)		(a) of Third-tier Corporation	(b) of Second-tier Corporation		

Section B—Dividends Paid Out of Pre-1987 Accumulated Profits (Include the column 8(b) results in Section A, column 6(b), of Part I above.)

1. Name of Third-Tier Foreign Corporation and Its Related Second-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Accumulated Profits for Tax Year Indicated (in functional currency—attach schedule)	5. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated (in functional currency—see instructions)	6. Dividends Paid (in functional currency)		7. Divide Column 6(a) by Column 4	8. Tax Deemed Paid (see instructions)	
					(a) of Third-tier Corporation	(b) of Second-tier Corporation		(a) In Functional Currency of Third-tier Corporation	(b) U.S. Dollars

Schedule E Tax Deemed Paid by Certain Third-, Fourth-, and Fifth-Tier Foreign Corporations Under Section 902(b)

Use this schedule to report taxes deemed paid with respect to dividends from eligible post-1986 undistributed earnings of fourth-, fifth- and sixth-tier controlled foreign corporations. ***Report all amounts in U.S. dollars unless otherwise specified.***

Part I—Tax Deemed Paid by Third-Tier Foreign Corporations (Include the column 10 results in Schedule D, Part II, Section A, column 6(b).)

1. Name of Fourth-Tier Foreign Corporation and Its Related Third-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated		7. Post-1986 Foreign Income Taxes (add columns 5, 6(a) and 6(b))	8. Dividends Paid (in functional currency)		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
					(a) Taxes Paid	(b) Taxes Deemed Paid (from Part II, column 10)		(a) Of Fourth-tier CFC	(b) Of Third-tier CFC		

Part II—Tax Deemed Paid by Fourth-Tier Foreign Corporations (Include the column 10 results in column 6(b) of Part I above.)

1. Name of Fifth-Tier Foreign Corporation and Its Related Fourth-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid and Deemed Paid for Tax Year Indicated		7. Post-1986 Foreign Income Taxes (add columns 5, 6(a) and 6(b))	8. Dividends Paid (in functional currency)		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
					(a) Taxes Paid	(b) Taxes Deemed Paid (from Part III, column 10)		(a) Of Fifth-tier CFC	(b) Of Fourth-tier CFC		

Part III—Tax Deemed Paid by Fifth-Tier Foreign Corporations (Include the column 10 results in column 6(b) of Part II above.)

1. Name of Sixth-Tier Foreign Corporation and Its Related Fifth-Tier Foreign Corporation	2. Tax Year End (Yr-Mo) (see instructions)	3. Country of Incorporation (enter country code from instructions)	4. Post-1986 Undistributed Earnings (in functional currency—attach schedule)	5. Opening Balance in Post-1986 Foreign Income Taxes	6. Foreign Taxes Paid For Tax Year Indicated	7. Post-1986 Foreign Income Taxes (add columns 5 and 6)	8. Dividends Paid (in functional currency)		9. Divide Column 8(a) by Column 4	10. Tax Deemed Paid (multiply column 7 by column 9)
							(a) Of Sixth-tier CFC	(b) Of Fifth-tier CFC		

Form **1118** (Rev. 12-2007)

Schedule F Gross Income and Definitely Allocable Deductions for Foreign Branches

	1. Name of Foreign Country or U.S. Possession (Use a separate line for each.)	2. Gross Income	3. Definitely Allocable Deductions
A			
B			
C			
D			
E			
F			
Totals (add lines A through F)* ▶			

* **Note:** *The Schedule F totals are not carried over to any other Form 1118 Schedule. (These totals were already included in Schedule A.) However, the IRS requires the corporation to complete Schedule F under the authority of section 905(b).*

Schedule G Reductions of Taxes Paid, Accrued, or Deemed Paid

A	Reduction of Taxes Under Section 901(e)—Attach separate schedule	
B	Reduction of Oil and Gas Extraction Taxes—Enter amount from Schedule I, Part II, line 6	
C	Reduction of Taxes Due to International Boycott Provisions—Enter appropriate portion of Schedule C (Form 5713), line 2b. **Important:** Enter only "specifically attributable taxes" here.	
D	Reduction of Taxes for Section 6038(c) Penalty—Attach separate schedule	
E	Other Reductions of Taxes—Attach schedule(s)	
	Total (add lines A through E). Enter here and on Schedule B, Part II, line 3 . . . . ▶	

Form **1118** (Rev. 12-2007)

Schedule H Apportionment of Deductions Not Definitely Allocable *(complete only once)*

Part I—Research and Development Deductions

	(a) Sales Method					(b) Gross Income Method—Check method used: ☐ Option 1 ☐ Option 2 (See page 9 of instructions.)		(c) Total R&D Deductions Not Definitely Allocable (enter all amounts from column (a)(v) or all amounts from column (b)(vii))
	Product line #1 (SIC Code:)*		Product line #2 (SIC Code:)*		(v) Total R&D Deductions Under Sales Method (add columns (ii) and (iv))			
	(i) Gross Sales	(ii) R&D Deductions	(iii) Gross Sales	(iv) R&D Deductions		(vi) Gross Income	(vii) Total R&D Deductions Under Gross Income Method	
1 Totals (see pages 8 and 9 of instructions)								
2 Total to be apportioned								
3 Apportionment among statutory groupings:								
a General category income								
b Passive category income								
c Section 901(j) income*								
d Income re-sourced by treaty*								
4 Total foreign (add lines 3a through 3d)								

*Important: See ***Computer-Generated Schedule H*** in instructions.

Form **1118** (Rev. 12-2007)

Schedule H **Apportionment of Deductions Not Definitely Allocable** *(continued)*

Part II—Interest Deductions, All Other Deductions, and Total Deductions

	(a) Average Value of Assets—Check method used: ☐ Fair market value ☐ Tax book value ☐ Alternative tax book value		(b) Interest Deductions		(c) All Other Deductions Not Definitely Allocable	(d) Totals (add the corresponding amounts from column (c), Part I; columns (b)(iii) and (b)(iv), Part II; and column (c), Part II). Enter each amount from lines 3a through 3d below in column 10 of the corresponding Schedule A.
	(i) Nonfinancial Corporations	(ii) Financial Corporations	(iii) Nonfinancial Corporations	(iv) Financial Corporations		
1a Totals (see pages 9 and 10 of instructions)						
b Amounts specifically allocable under Temp. Regs. 1.861-10T(e)						
c Other specific allocations under Temp. Regs. 1.861-10T						
d Assets excluded from apportionment formula						
2 Total to be apportioned (subtract the sum of lines 1b, 1c, and 1d from line 1a)						
3 Apportionment among statutory groupings:						
a General category income						
b Passive category income						
c Section 901(j) income*						
d Income re-sourced by treaty*						
4 Total foreign (add lines 3a through 3d)						

* **Important:** *See* ***Computer-Generated Schedule H*** *in instructions.*

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Form **1118** (Rev. 12-2007)

Schedule J (Form 1118)
(Rev. December 2007)
Department of the Treasury
Internal Revenue Service

Adjustments to Separate Limitation Income (Loss) Categories for Determining Numerators of Limitation Fractions, Year-End Recharacterization Balances, and Overall Foreign and Domestic Loss Account Balances

For calendar year 20 ______, or other tax year beginning ____________, 20 ____, and ending ____________, 20 ______

▶ Attach to Form 1118. For Paperwork Reduction Act Notice, see the Instructions for Form 1118.

OMB No. 1545-0122

Name of corporation | **Employer identification number**

Part I Adjustments to Separate Limitation Income or (Losses) in Determining Numerators of Limitation Fractions (see instructions)

		(i) General category income	(ii) Passive category income	(iii) Other income*	(iv) U.S. income
1	Income or (loss) before adjustments				
2	Allocation of separate limitation losses:				
a	General category income		( )	( )	
b	Passive category income	( )		( )	
c	Other income*	( )	( )		
3	**Subtotal**—Combine lines 1 through 2c.				
4	Allocation of overall foreign losses				( )
5	Allocation of domestic losses	( )	( )	( )	
6	**Subtotal**—Combine lines 3 through 5.				
7	Recapture of overall foreign losses	( )	( )	( )	
8	**Subtotal**—Combine lines 6 and 7.				
9	Recharacterization of separate limitation income:				
a	General category income	( )			
b	Passive category income		( )		
c	Other income*			( )	
10	Recapture of overall domestic losses				( )
11	**Numerator of Limitation Fraction**—Combine lines 8 through 10. Enter each result here and on Part II, line 6, of corresponding Schedule B.				

Part II Year-End Balances of Future Separate Limitation Income That Must Be Recharacterized (section 904(f)(5)(C))

		(i)	(ii)	(iii)
a	General category income			
b	Passive category income			
c	Other income*			

Part III Overall Foreign Loss Account Balances (section 904(f)(1))
*Complete for **each** separate limitation income category.*

		(i)	(ii)	(iii)
1	Beginning balance			
2	Current year additions			
3	Current year reductions (other than recapture)	( )	( )	( )
4	Current year recapture (from Part I, line 7)	( )	( )	( )
5	**Ending balance**—Combine lines 1 through 4.			

Part IV Overall Domestic Loss Account Balances (section 904(g)(1))

		(i)	(ii)	(iii)
1	Beginning balance			
2	Current year additions			
3	Current year reductions (other than recapture)	( )	( )	( )
4	**Subtotal**—Combine lines 1 through 3.			
5	Current year recapture (from Part I, line 10)			
6	**Ending balance**—Subtract line 5 from line 4.			

* **Important:** *See **Computer-Generated Schedule J** in instructions.*   Cat. No. 10309U   **Schedule J (Form 1118) (Rev. 12-2007)**

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–64

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on July 16, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

South Carolina Benevolent Society, Inc.
Columbia, SC

Home Buyers Assistance Foundation, Inc.
Woodstock, GA

Angel Wings Cat Rescue and Sanctuary
Kingston, KY

Brian Lees Sports Spectrum
Grand Rapids, MI

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through September 2007. This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through September 2007.

Rev. Rul. 2007–46

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of bond factor amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period January through September 2007.

Table 1
Rev. Rul. 2007–46
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Jan '07	17.39	32.44	45.52	56.97	66.95	69.23	71.86	74.74	78.09	81.82	85.82
Feb '07	17.39	32.44	45.52	56.97	66.95	69.08	71.70	74.56	77.89	81.60	85.57
Mar '07	17.39	32.44	45.52	56.97	66.95	68.92	71.53	74.39	77.71	81.40	85.33
Apr '07	17.39	32.44	45.52	56.97	66.95	68.77	71.37	74.22	77.52	81.19	85.11
May '07	17.39	32.44	45.52	56.97	66.95	68.62	71.22	74.05	77.35	81.00	84.89
Jun '07	17.39	32.44	45.52	56.97	66.95	68.47	71.06	73.89	77.17	80.81	84.68
Jul '07	17.39	32.44	45.52	56.97	66.95	68.32	70.91	73.74	77.01	80.63	84.47
Aug '07	17.39	32.44	45.52	56.97	66.95	68.18	70.76	73.58	76.84	80.45	84.28
Sep '07	17.39	32.44	45.52	56.97	66.95	68.04	70.62	73.43	76.68	80.27	84.09

Table 1 (cont'd)
Rev. Rul. 2007–46
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2004	2005	2006	2007							
Jan '07	89.79	93.41	96.70	97.21							
Feb '07	89.50	93.07	96.27	97.21							
Mar '07	89.22	92.75	95.89	97.21							

Table 1 (cont'd) Rev. Rul. 2007–46 Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits											
	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2004	2005	2006	2007							
Apr '07	88.96	92.46	95.57	97.21							
May '07	88.72	92.18	95.28	97.21							
Jun '07	88.48	91.93	95.02	97.21							
Jul '07	88.25	91.69	94.79	97.21							
Aug '07	88.04	91.46	94.58	97.21							
Sep '07	87.83	91.25	94.39	97.21							

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3, 1998–1 C.B. 248; Rev. Rul. 2001–2, 2001–1 C.B. 255; Rev. Rul. 2001–53, 2001–2 C.B. 488; Rev. Rul. 2002–72, 2002–2 C.B. 759; Rev. Rul. 2003–117, 2003–2 C.B. 1051; Rev. Rul. 2004–100, 2004–2 C.B. 718; Rev. Rul. 2005–67, 2005–2 C.B. 771; and Rev. Rul. 2006–51, 2006–2 C.B. 632.

DRAFTING INFORMATION

The principal author of this revenue ruling is David McDonnell of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. McDonnell at (202) 622–3040 (not a toll-free call).

Section 162.—Trade or Business Expenses

26 CFR 1.162–1: Business expenses.
(Also §§ 461; 831.)

Insurance premium. This ruling holds that an arrangement that provides for the reimbursement of inevitable future costs does not involve the requisite insurance risk for purposes of determining (i) whether the amount paid for the arrangement is deductible as an insurance premium and (ii) whether the assuming entity may account for the arrangement as an 'insurance contract' for purposes of subchapter L of the Code. Stakeholders are asked to comment on the application of the rationale of the revenue ruling outside of its facts. Rev. Rul. 89–96 amplified.

Rev. Rul. 2007–47

ISSUE

Does the arrangement described below involve the requisite insurance risk to constitute insurance for purposes of determining (i) whether *X* may deduct the amount paid under the arrangement as an "insurance premium" under § 162 of the Internal Revenue Code, and (ii) whether *IC* may account for the arrangement as an "insurance contract" for purposes of subchapter L of the Code?

FACTS

X, a domestic corporation that uses an accrual method of accounting, is engaged in a Business Process that is inherently harmful to people and property. Applicable governmental regulations require *X* to take action to remediate that harm. Doing so will require *X* to incur Future Costs to undertake specific measures to restore *X*'s business location to its condition before Business Process began; the Future Costs will be incurred when *X* ceases to engage in Business Process. The exact amount and timing of the Future Costs are a function of many factors, including the future cost of wages, future cost of materials, future changes in the regulation of Business Process, and the timing of *X*'s discontinuation of Business Process. There is no uncertainty, however, that the Future Costs will be incurred.

When *X* began Business Process in Year 1, it estimated that the present value of Future Costs was \$150*x*, based on its evaluation of the factors identified above and an appropriate discount rate based on economic projections. At that time, *X* entered into an arrangement with *IC*, an unrelated domestic insurance company taxable under § 831. Under the arrangement, *X* agreed to pay *IC* \$150*x*, and *IC* agreed to reimburse *X* for its Future Costs, up to a limit of \$300*x*. The arrangement had no limits on its duration.

LAW

Section 162(a) provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162–1(a) of the Income Tax Regulations provides, in part, that among the items included in deductible business expenses are insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business.

Section 461 provides that the amount of any deduction shall be taken for the taxable year which is the proper taxable year under the method of accounting used by the taxpayer in computing taxable income. Under § 1.461–1(a)(2), a liability is incurred and generally is taken into account under an accrual method of accounting in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has oc-

curred with respect to the liability. Section 1.461–4(g)(5) provides that if a liability arises out of the provision to the taxpayer of insurance, economic performance occurs as payment is made to the person to which the liability is owed. If the period of coverage extends substantially beyond the close of the taxable year, however, the amount permitted to be taken into account in the year of payment is determined under the capitalization rules of § 263. Section 1.461–4(g)(8)(Ex. 6); § 1.263–4(d)(3)(i).

Characterization of an arrangement as insurance has consequences for the issuer, as well. Section 831(a) provides that taxes, computed as provided in § 11, are imposed for each taxable year on the taxable income of each insurance company other than a life insurance company. Section 832(a) provides that for this purpose, taxable income means the gross income as defined in § 832(b)(1) less the deductions allowed by § 832(c). Gross income includes underwriting income, which is defined in § 832(b)(3) as premiums earned on insurance contracts during the taxable year, less losses incurred and expenses incurred. Premiums earned and losses incurred on insurance contracts are computed taking into account reserves for unearned premiums under § 832(b)(4) and for discounted unpaid losses under § 832(b)(5), respectively. If an arrangement is not an insurance contract, no reserves are permitted for unearned premiums or for discounted unpaid losses with respect to the arrangement. Even if an arrangement is an insurance contract, no reserve is permitted for discounted unpaid losses until a loss has been "incurred."

Neither the Code nor the regulations define the terms "insurance" or "insurance contract." The Supreme Court of the United States has explained that in order for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must be present. *Helvering v. Le Gierse*, 312 U.S. 531 (1941). The risk transferred must be risk of economic loss. *Allied Fidelity Corp. v. Commissioner*, 572 F.2d 1190, 1193 (7th Cir. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency, *Commissioner v. Treganowan*, 183 F.2d 288, 290–91 (2d Cir. 1950), and must not be merely an investment or business risk. *Le Gierse*, 312 U.S. at 542; Rev. Rul. 89–96, 1989–2 C.B. 114.

In *Le Gierse*, the Court found that complementary annuity and insurance contracts did not involve an insurance risk but rather an investment risk because the risk assumed by the issuer was only that the amount the taxpayer paid for the contracts would earn less than the amount paid to the taxpayer as an annuity; the total amount paid by the taxpayer exceeded the face value of the life insurance contract. This risk, the Court said, "was an investment risk similar to the risk assumed by a bank; it was not an insurance risk." *Le Gierse*, 312 U.S. at 542.

In *Treganowan*, the court held that a program under which the surviving members of the New York Stock Exchange paid a certain sum to the families of deceased members constituted insurance; the court distinguished the holding of *Le Gierse* as follows:

> The holding [of *Le Gierse*] really highlights the situation here where the payment is actually conditioned upon death, whenever occurring, in the true terms of insurance. "From an insurance standpoint there is no risk unless there is uncertainty, or, to use a better term, fortuitousness. It may be uncertain whether the risk will materialize in any particular case. Even death may be considered fortuitous, because the time of its occurrence is beyond control." 8 Ency.Soc.Sc. 95. That fortuitousness, whether we speak of death generally or premature death, as the Tax Court wished to emphasize, seems perfectly embodied here to fit both branches of the Supreme Court's test.

Treganowan, 183 F.2d at 290–91. *See also Allied Fidelity Corp.*, 572 F.2d at 1193 ("[T]he insurer undertakes no present duty of performance but stands ready to assume financial burden of any covered loss," citing Couch on Insurance § 1:2 (1959)).

The Supreme Court has applied a similar standard to determine what constitutes "the business of insurance" for purposes of § 2(b) of the McCarran-Ferguson Act, 59 Stat. 34, as amended, 61 Stat. 448, 15 U.S.C. § 1012(b). In *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979), the Court concluded that agreements between Blue Shield of Texas and three pharmacies for the provision of prescription drugs to Blue Shield policyholders did not constitute "the business of insurance" within the meaning of the McCarran-Ferguson Act, noting that "[t]he primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk." The Court considered the legislative history of the Act, quoting approvingly from one of the early House Reports, as follows: "'The theory of insurance is the distribution of risk according to hazard, experience, and the laws of averages. These factors are not within the control of insuring companies in the sense that the producer or manufacturer may control cost factors.'" *Group Life & Health Ins. Co.*, 440 U.S. at 221 (quoting H.R. Rep. No. 873, 78th Cong., 1st Sess., 8–9 (1943)). Non-tax insurance treatises further confirm that arrangements entered into to manage losses that are at least substantially certain to occur, or that are not the result of fortuitous events, do not constitute insurance. *See, e.g., Couch on Insurance*, § 102:8 (losses that exist at the time of the insuring agreement, or that are so probable or imminent that there is insufficient "risk" being transferred between the insured and insurer, are not proper subjects of insurance); 1 *Appleman on Insurance 2d,* § 1.4 ("The fortuity principle is central to the notion of what constitutes insurance. The insurer will not and should not be asked to provide coverage for a loss that is reasonably certain or expected to occur within the policy period."); 43 Am. Jur. 2d *Insurance*, § 479 (2005). *See also* Warren Freedman, *Freedman's Richards on Insurance* § 1:2 (6th ed. 1990) (insurance is an aleatory contract); *Restatement (First) of Contracts* § 291 (1932) (aleatory contract is one premised on happening of fortuitous event; that time or amount of performance depends on fortuitous event does not mean contract is aleatory).

In Rev. Rul. 89–96, 1989–2 C.B. 114, *Y*, a taxpayer that had already experienced a catastrophic loss, entered into a "liability insurance" contract with *Z*, an unrelated casualty insurance company. The exact amount of *Y*'s liability to injured persons as a result of the catastrophe could not be ascertained, but was expected to be substantially in excess of $130x. At the time the catastrophe occurred, *Y*'s liability insurance coverage totaled $30x. Under the contract between *Y* and *Z*, *Y* paid a premium of $50x in exchange for additional "liability insurance" coverage of

$100x. That is, *Z* promised to pay on behalf of *Y* amounts in excess of $30x for which *Y* would become liable, subject to the contract's limit of $100x. The $50x "premium" charged *Y* was an amount that, together with *Z*'s investment earnings and tax savings, would yield at least *Z*'s maximum anticipated liability of $100x by the time claims were liquidated. The ruling concludes that the arrangement does not involve the requisite risk shifting necessary for insurance, because the catastrophe had already occurred and the economic terms of the contract demonstrate the absence of any risk apart from an investment risk (that is, the risk *Z* would be required to pay out $100x earlier than anticipated, or that actual investment yield would be lower than forecast).

ANALYSIS

In order to determine the nature of an arrangement for federal income tax purposes, it is necessary to consider all the facts and circumstances in a particular case, including not only the terms of the arrangement, but also the entire course of conduct of the parties. Thus, an arrangement that purports to be an insurance contract but that lacks the requisite insurance risk, or fortuity, may instead be characterized as a deposit arrangement, a loan, a contribution to capital (to the extent of net value, if any), an option or indemnity contract, or otherwise, based on the substance of the arrangement between the parties. The proper characterization of the arrangement may determine whether the issuer qualifies as an insurance company and whether amounts paid under the arrangement may be deductible.

In the present case, the requirement that *X* incur Future Costs attached at the time *X* began Business Process; no insurance risk or hazard, such as a hurricane or an accident, exists as to whether *X* will have to incur those costs; it is certain that *IC* will have to perform under the arrangement with *X* by reimbursing *X* for the costs incurred to perform the measures, subject to the contract limit of $300*x*. Economically, the arrangement is a prefunding by *X* of its future obligations. Although *IC* assumed the risks of (i) the scope of the required measures, (ii) projections of future labor and material costs, (iii) the likely time frame when Future Costs would be incurred, and (iv) an appropriate discount rate based on projections of future investment earnings, the overall risk assumed by *IC* was whether the estimated present value of the cost of performing the measures ($150x) would accrue to exceed the greater of *X*'s costs to perform the required measures or the contract limit of $300x. This risk is akin to the timing and investment risks that Rev. Rul. 89–96 concludes are not insurance risks. Accordingly, the arrangement between *X* and *IC* lacks the requisite insurance risk to constitute insurance under the authorities set forth above.

HOLDING

The arrangement between *X* and *IC* lacks the requisite insurance risk to constitute insurance for purposes of determining (i) whether *X* may deduct the amount paid under the arrangement as an "insurance premium" under § 162 of the Internal Revenue Code, and (ii) whether *IC* may account for the arrangement as an "insurance contract" for purposes of subchapter L of the Code.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 89–96, 1989–2 C.B. 114, is amplified.

REQUEST FOR COMMENTS

A revenue ruling represents the conclusion of the Internal Revenue Service (IRS) on the application of the law to the pivotal facts stated therein. Accordingly, this revenue ruling does not apply to reinsurance arrangements (including retroactive reinsurance, such as loss portfolio transfers), arrangements covering unanticipated environmental exposures, arrangements covering unanticipated cost overruns, or arrangements involving product warranties. The IRS may apply, or not apply, the authorities cited in this ruling to such arrangements, according to the facts and circumstances presented on a case-by-case basis. Comments are requested concerning the need for guidance in these and other areas. Comments should be submitted by October 22, 2007. Comments may be submitted by mail addressed to: Internal Revenue Service, CC:PA:LPD:PR (Rev. Rul. 2007–47), P.O. Box 7604, Ben Franklin Station, Washington, DC 20044; by hand delivery (Monday through Friday between the hours of 8:00 a.m. through 4:00 p.m.) addressed to: Courier's Desk, Internal Revenue Service, Attn.: CC:PA:LPD:PR (Rev. Rul. 2007–47), Room 5203, 1111 Constitution Avenue, NW, Washington, DC 20224; or by email addressed to: *Notice.Comments@irscounsel.treas.gov*. Commentators should include the identification number of the publication (Rev. Rul. 2007–47) in both the email subject line and the body of the comment.

DRAFTING INFORMATION

The principal author of this revenue ruling is John E. Glover of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Mr. Glover at (202) 622–3970 (not a toll-free call).

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(b)–1: Treatment of beneficiary of trust not exempt under section 501(a).
(Also: §§ 83, 404, 409A, 661, 663, 671, 3101, 3102, 3111, 3121, 3301, 3306, 3401, 3402, 1.83–3, 1.83–8, 1.404(a)–12, 1.409A–1, 31.3102–1, 31.3121(a)–2, 31.3401(d)–1, 31.3402(a)–1.)

Nonexempt employees' trusts. This ruling considers the federal tax consequences to the employees, the employer, and the trust when an employer contributes to a nonexempt employees' trust on behalf of highly compensated employees. It also explains the effects of vesting of an employee's interest in the trust and distributions from the trust. Rev. Rul. 74–299 amplified.

Rev. Rul. 2007–48

ISSUE

When an employer contributes to a nonexempt employees' trust on behalf of highly compensated employees, what are the Federal tax consequences to the employees, the employer, and the trust of contributions to the trust, vesting of an employee's interest in the trust, and distributions from the trust?

FACTS

X corporation has created a deferred compensation plan (Plan) for 50 key executives (participants), all of whom are highly compensated employees within the meaning of § 414(q) of the Internal Revenue Code. Pursuant to the Plan, *X* contributes each year on behalf of each participant to a trust, *T*. No contributions by participants to *T* are required or permitted. The Plan fails to satisfy the provisions of § 410(b) as well as other qualification requirements of § 401(a). Therefore, *T* is not and never has been a qualified trust under § 401(a) and is not exempt from taxation under § 501(a).

T was established under state law as a trust for the benefit of all of the Plan participants. *T*'s assets can revert to *X* only after all liabilities to participants and beneficiaries under the Plan have been satisfied. *T*'s assets are not subject to the claims of *X*'s creditors. Separate accounts that reflect the participant's share of the net trust assets and income are maintained for each participant. *T* is not a foreign trust within the meaning of § 7701(a)(31).

A participant's entire interest in *T* becomes vested upon completion of two years of service with *X* beginning on the date the individual first becomes a participant in the Plan. Participants or their beneficiaries are entitled to receive their vested interest in the net assets of *T*, net of applicable withholding and other taxes, on death, disability, or termination of employment. In addition, *T* is required to distribute to each participant each year an amount that the trustee reasonably estimates will be equal to the amount of Federal, state, and local income and employment taxes payable by the participant with respect to the increase in the participant's vested accrued benefit in *T* during such year. *T* is permitted to make the distribution in part as a distribution of cash to the participant, and in part in the form of applicable employment tax withholding under Federal, state, or local law. *X* and *T* file income tax returns on a calendar year basis.

On each of January 1, 2007, 2008, 2009, and 2010, *X* contributes $100,000 to *T* on behalf of participant *A* under the Plan. As of the close of business on December 31, 2008, the fair market value of *A*'s interest in *T* is $214,000, which includes income and realized and unrealized gains and losses on *T*'s assets. *A*'s interest in *T* first becomes vested on January 1, 2009. As of the close of business on January 1, 2009, the fair market value of *A*'s interest in *T* is $314,000 (including a contribution of $100,000 from *X* on that date). *A* files income tax returns on a calendar year basis.

In 2009, the trustee distributes $132,000 to *A*. Part of the distribution is in the form of withholding of applicable Federal, state, and local income and employment taxes and the remainder is cash. *T*'s distributable net income allocable to *A*'s account for 2009 is $15,000. The fair market value of *A*'s interest in *T* at the end of 2009 (after the distribution) is $198,000.

In 2010, the trustee distributes $48,000 to *A*. Again, part of the distribution is in the form of withholding of applicable Federal, state, and local income and employment taxes and the remainder is cash. *T*'s distributable net income allocable to *A*'s account for 2010 is $16,000. The fair market value of *A*'s interest in *T* at the end of 2010 (after the distribution) is $270,000.

LAW AND ANALYSIS

Income Tax Treatment

For Participant

Section 83(a) provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount (if any) paid for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83–8(a) of the Income Tax Regulations provides generally that § 83 applies to a transfer to or from a trust for the benefit of employees, independent contractors, or their beneficiaries if the trust is not described in § 401(a). To the extent such a transfer is subject to § 402(b), however, § 83 applies to the transfer only as provided for in § 402(b).

Section 402(b)(1) provides that employer contributions to an employees' trust not exempt from tax under § 501(a) (a nonexempt employees' trust) are included in the employee's gross income in accordance with § 83, except that the value of the employee's interest in the trust is substituted for the property's fair market value in applying § 83. Section 1.402(b)–1(a)(1) provides that employer contributions to a nonexempt employees' trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in the contribution is substantially vested. Because *T* is a nonexempt employees' trust whose assets are derived solely from employer contributions, the entire trust is treated as a nonexempt employees' trust subject to the provisions of § 402(b).

Section 402(b)(2) provides that the amount actually distributed or made available to an employee by a nonexempt employees' trust shall be taxable in the taxable year in which distributed or made available to the employee under § 72 (relating to annuities), except that distributions of income of the trust before the annuity starting date (as defined in § 72(c)(4)) shall be included in the employee's gross income without regard to § 72(e)(5) (relating to amounts not received as annuities).

Section 402(b)(4)(A) provides that if one of the reasons a trust is not exempt from tax under § 501(a) is the failure of the plan of which it is a part to meet the requirements of § 401(a)(26) or § 410(b), then a highly compensated employee (as defined in § 414(q)) shall, in lieu of the amount determined under § 402(b)(1) or (2), include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the vested accrued benefit of the employee (other than the employee's investment in the contract) as of the close of the taxable year of the trust.

Section 409A generally provides that unless certain requirements are met, amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture. Section 409A also includes rules applicable to certain trusts or similar arrangements associated with a nonqualified deferred compensation plan, where such arrangements are located outside of the United States or are restricted to the provision of benefits in connection with a decline in the financial health of

the sponsor. Under § 1.409A–1(b)(6)(i), a right to compensation income that will be required to be included in income under § 402(b)(4) is not a deferral of compensation for purposes of § 409A. Although the regulations under § 409A generally apply for taxable years beginning on or after January 1, 2008, taxpayers may rely on such regulations for taxable years beginning before January 1, 2008.

Because the Plan does not meet the requirements of § 410(b) and *A* is a highly compensated employee (as defined in § 414(q)), § 402(b)(4)(A) determines the tax consequences to *A* of *A*'s interest in *T*. Because *A* has no vested accrued benefit in *T* in 2007 or 2008, *A* has no gross income on account of *A*'s interest in *T* for those years. See § 1.83–3(c)(4), Example (1).

For 2009, pursuant to § 402(b)(4)(A), *A* must include in gross income as compensation $330,000, which is *A*'s vested accrued benefit (the $198,000 fair market value of *A*'s account in *T* as of the end of 2009, plus the $132,000 distributed to *A* in 2009 to satisfy applicable withholding requirements and *A*'s anticipated tax liability for 2009, less *A*'s investment in the contract as of the end of 2008, which was zero). For 2010, *A* must include in gross income as compensation $120,000, which is *A*'s vested accrued benefit under § 402(b)(4)(A) (the $48,000 distributed to *A* in 2010 to satisfy applicable withholding requirements and *A*'s anticipated tax liability for 2010, plus the $270,000 fair market value of *A*'s interest in *T* at the end of the taxable year of *T*, less *A*'s investment in the contract as of the end of 2009, which was $198,000).

For Employer

Section 404(a) provides the general deduction timing rules applicable to any plan or arrangement for the deferral of compensation, regardless of the Code section under which the amounts might otherwise be deductible. Pursuant to § 404(a)(5), contributions paid by an employer to or under a deferred compensation plan or arrangement that is not included in § 404(a)(1), (2), or (3) (a nonqualified plan) are deductible in the taxable year in which amounts attributable to the contributions are includible in the gross income of the employees participating in the plan or arrangement, provided that the contributions otherwise meet the requirements for deductibility. In the case of a nonqualified plan in which more than one employee participates, contributions are deductible only if separate accounts are maintained for each employee.

Section 1.404(a)–12(b)(3) provides that in the case of a funded nonqualified plan under which more than one employee participates, no deduction is allowable under § 404(a)(5) for any contribution unless separate accounts are maintained for each employee. The requirement of separate accounts does not require that a separate trust be maintained for each employee. However, a separate account must be maintained for each employee to which employer contributions under the plan are allocated, along with any income earned thereon. In addition, the accounts must be sufficiently separate and independent to qualify as separate shares under § 663(c).

The separate account requirement does not bar *X* from deducting contributions to *T* because *T* satisfies the separate account requirement. However, because *A* does not include in income any amount attributable to *X*'s contributions to *T* on behalf of *A* until 2009, none of those contributions is deductible by *X* before 2009. For 2009, because *A* includes in that year all amounts attributable to the $100,000 contributions made by *X* in each of 2007, 2008, and 2009, *X* may deduct $300,000 for contributions to *T* made on behalf of *A*, assuming such contributions are otherwise deductible. For 2010, because *A* includes in that year all amounts attributable to the $100,000 contribution made in the year, *X* may deduct $100,000 for contributions to *T* made on behalf of *A*, assuming such contributions are otherwise deductible.

For Trust

Section 671 provides that where a grantor is treated as the owner of any portion of a trust under subpart E of part I of subchapter J of chapter 1 (subpart E), there are included in computing the grantor's taxable income and credits those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust (to the extent that those items could be taken into account in computing the taxable income or credits against the tax of an individual). Sections 673 through 678 specify the circumstances that cause a taxpayer to be regarded as the owner of a portion of a trust. However, the rules of §§ 402(b) and 404(a)(5) preclude a § 402(b) employees' trust from being treated as owned by the employer under subpart E.

Section 641(a) provides that the tax imposed by § 1(e) applies to the taxable income of any kind of property held in trust.

Section 661(a) provides that in computing the taxable income of an estate or trust a deduction is allowed for distributions to beneficiaries equal to the sum of the amount of income for the taxable year that is required to be distributed currently and any other amounts properly paid or credited or required to be distributed for the taxable year. However, the total amount deductible under § 661(a) cannot exceed the distributable net income as computed under the provisions of § 643(a).

Section 663(c) provides that for the sole purpose of determining the amount of distributable net income in the application of § 661, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust are treated as separate trusts.

Rev. Rul. 74–299, 1974–1 C.B. 154, holds that a nonexempt employees' trust is allowed a deduction under § 661(a) for distributions to a retired employee under a deferred compensation plan. Where the separate share rule of § 663 applies to the trust, the trust's deduction under § 661(a) is limited to the distributee's separate share of the trust's distributable net income. The taxation of the distributions is not governed by the provisions of § 662.

In the present case, *T* is taxed as a trust under § 641. *T*'s deduction under § 661(a) is limited to $15,000 for 2009 and $16,000 for 2010 because in each of those years the distributed amount (including the amount used to satisfy withholding requirements and distributed to *A* to satisfy *A*'s anticipated tax liability) exceeds *T*'s distributable net income allocable to *A*'s separate share in *T* for those years.

Employment Tax Treatment

Sections 3101 and 3111 impose Federal Insurance Contributions Act (FICA) taxes on "wages," as that term is defined in § 3121(a). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed both on the employer under § 3111(a) and (b) and on the em-

ployee under § 3101(a) and (b). Section 3102(a) provides that the employee portion of FICA tax must be collected by the employer of the taxpayer by deducting the amount of the tax from the wages as and when paid. Section 31.3102–1(a) of the Employment Tax Regulations provides that the employer is required to collect the tax, notwithstanding that wages are paid in something other than money. Section 3121(a) defines "wages" for FICA purposes as all remuneration for employment including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exceptions. Section 31.3121(a)–2(a) provides that "[w]ages are paid by an employer at the time that they are actually or constructively paid" unless certain exceptions not relevant here apply. Section 3121(b) defines "employment" for FICA purposes as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Rules similar to the FICA rules apply with respect to Federal Unemployment Tax Act (FUTA) tax under §§ 3301, 3306(b), and 3306(c).

Section 3402(a), relating to Federal income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon these wages a tax determined in accordance with prescribed tables or computational procedures. Section 31.3402(a)–1(b) provides that the employer is required to collect Federal income tax withholding by deducting and withholding the amount thereof from the employee's wages as and when paid, either actually or constructively. Under § 31.3402(a)–1(c), an employer is required to deduct and withhold income tax notwithstanding that the wages are paid in something other than money (for example, wages paid in stock or bonds) and to pay over the tax in money. Section 3401(a) provides that "wages" for Federal income tax withholding purposes means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exceptions.

Section 31(a)(2) provides that an amount of Federal income tax withheld during a calendar year from wages is allowed as a credit against income tax for the taxable year of the employee beginning in such calendar year.

Under section 6672(a), any person required to collect, truthfully account for, and pay over any internal revenue tax who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat such tax or the payment thereof, shall, in addition to other penalties, be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. A trustee can be liable for unpaid employment and withholding taxes. *See* Rev. Rul. 84–83, 1984–1 C.B. 264.

Rev. Rul. 67–351, 1967–2 C.B. 86, concludes that certain contributions to an employees' trust are subject to employment taxes at the time of contribution. In Rev. Rul. 67–351, pursuant to a collective bargaining agreement between a union and a group of employers, a vacation plan and trust are established for the benefit of the employees. The agreement provides that the employers will pay into the trust a specified amount for each hour worked by qualified employees. An individual account is established for each qualified employee by the trustees of the trust. The individual employee's interest in the amount in his vacation account is fully vested and nonforfeitable from the time the money is paid by his employer. The ruling concludes that the contributions to the trust are includible in gross income at the time they are contributed to the trust. Furthermore, the ruling holds that the contributions to the trust are payments of wages for purposes of the FICA, the FUTA, and Federal income tax withholding at the time they are contributed to the trust.

In Rev. Rul. 79–305, 1979–2 C.B. 350, a corporation transfers to an employee common stock subject to a substantial risk of forfeiture. The ruling holds that, under § 83, the fair market value of the stock at the time the substantial risk of forfeiture lapses is includible in the employee's gross income for the year in which the substantial risk of forfeiture lapses. The ruling also holds that the employee has received a payment of wages for purposes of the FICA, the FUTA, and Federal income tax withholding at the time the substantial risk of forfeiture lapses equal to the fair market value of the stock.

Section 3401(d)(1) provides that if the person for whom the individual performs services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages. Section 3401(d)(1) applies as well to the employer and employee portions of FICA tax, and to FUTA tax. See *Otte v. United States*, 419 U.S. 43 (1974); *In re Armadillo Corp.*, 561 F.2d 1382 (10th Cir. 1977); and *Lane Processing Trust v. United States*, 25 F.3d 662 (8th Cir. 1994). Section 31.3401(d)–1(f) clarifies that § 3401(d)(1) applies if the person for whom the individual performs the services does not have legal control of the payment of wages. The regulation provides as an example the payment of pensions or retired pay by a trust.

For FICA and FUTA purposes, contributions to a nonexempt employees' trust are taken into account as wages only once, either at the time of contribution or the time of vesting. Treas. Reg. §§ 31.3121(a)–2(a) & 31.3102–1(a). Employer contributions to such a trust are wages at the time of contribution to the extent that the employee's interest in the amount contributed is vested at the time of contribution. To the extent the employee's interest is not vested at the time of contribution, the contributions are not wages at the time contributed. Rather, for FICA and FUTA tax purposes, the employee receives a payment of wages on the date of vesting in an amount equal to the fair market value of the employee's interest in the trust attributable to the amount contributed (*i.e.*, the amount contributed plus any increase in the value of the trust with respect to the contributions or less any decrease in the value of the trust with respect to the contributions up to the date of vesting). Because neither *X*'s contributions nor *A*'s interest in *T* are vested during 2007 or 2008, *A* has no vested accrued benefit for 2007 or 2008. Therefore, *A* does not receive a payment of wages for FICA and FUTA tax purposes for these years. Because *X*'s contributions of $100,000 on each of January 1, 2009, and January 1, 2010, are vested at the time they were made, those contributions are treated as payments of wages subject to FICA and FUTA taxes at the time of contribution. *X* is the employer responsible for FICA and FUTA taxes on the 2009 and 2010 contributions. Furthermore, when *A*'s interest

in *T* vests on January 1, 2009, *A* receives a payment of wages on that date for FICA and FUTA tax purposes in the amount of *A*'s vested accrued interest on that date, *i.e.*, the fair market value of *A*'s interest in *T* that is attributable to the contributions made in 2007 and 2008 (not including the amount contributed by *X* on January 1, 2009, on which FICA and FUTA taxes are owed by *X*). *T* is the employer under § 3401(d)(1) for FICA and FUTA tax purposes with respect to the amount attributable to the contributions made in 2007 and 2008. In applying the annual social security tax and FUTA wage bases under §§ 3121(a)(1) and 3306(b)(1), all of the wages paid during 2009 in connection with *A*'s interest in *T* are taken into account, including the wages attributable to contributions made in 2007 and 2008.

The rule for determining the amount and the timing of the payment of wages subject to Federal income tax withholding follows the rule in § 402(b)(4)(A) for determining the amount and timing of gross income received by *A*, rather than the rule for determining the amount and the timing of the payment of wages for FICA and FUTA purposes. The legislative history of §§ 3401 through 3404 indicates that an objective of Federal income tax withholding is to enable individuals to pay the correct amount of income tax. H.R. Conf. Rep. No. 78–510 at 1 (1943). Congress has also stated that because the social security system has objectives that are significantly different from the objectives underlying the Federal income tax withholding rules, an amount may be treated differently for FICA purposes than it is for Federal income tax withholding purposes. See the legislative history to the Social Security Amendments of 1983 at S. Rep. No. 98–23, 42 (1983). Aligning the rule for Federal income tax withholding with the rule for determining the amount and timing of compensation included in the employee's gross income will result in the amount of Federal income tax withheld more precisely approximating the employee's income tax liability. A rule that determined wages for income tax withholding purposes at the time of vesting rather than at the end of the trust's taxable year could result in either overwithholding or underwithholding. Thus, in order to apply §§ 3401(a) and 3402(a) consistent with their purpose, the wages of a highly compensated employee (within the meaning of § 414(q)) with a vested accrued benefit in a nonexempt employees' trust are treated as paid for Federal income tax withholding purposes on the last day of the taxable year of the trust. The employer does not make a payment of wages for income tax withholding purposes at the time it makes contributions to such a trust even if the contributions are vested at the time of contribution. The nonexempt employees' trust is the employer within the meaning of § 3401(d)(1) for Federal income tax withholding purposes and is responsible for all Federal income tax withholding obligations with respect to wages that are also gross income determined under § 402(b)(4)(A).

In accordance with the foregoing, *A*'s wages for FICA and FUTA purposes attributable to contributions made in 2007 and 2008 are treated as paid on January 1, 2009, the date on which *A*'s interest vests, in an amount equal to $214,000, which is the fair market value of *A*'s interest in *T* on January 1, 2009, disregarding the $100,000 contribution from *X* on that date. *A*'s wages for FICA and FUTA purposes for 2009 and 2010 are treated as paid on January 1, 2009 and January 1, 2010, and for each year are in an amount equal to *X*'s vested contribution of $100,000 on each such date. *A*'s wages for Federal income tax withholding purposes attributable to contributions made in 2007, 2008, and 2009 are treated as paid on December 31, 2009, in an amount equal to $330,000, which is the excess on that date of *A*'s vested accrued benefit in *T* over *A*'s investment in the contract. *A*'s wages for Federal income tax withholding purposes for 2010 are treated as paid on December 31, 2010, in an amount equal to $120,000, which is the excess on that date of *A*'s vested accrued benefit in *T* over *A*'s investment in the contract.

X is the employer for FICA and FUTA purposes with respect to *A*'s wages resulting from *X*'s vested contributions to *T* in 2009 and 2010. *T* is the employer within the meaning of § 3401(d)(1) for FICA and FUTA purposes with respect to *A*'s wages attributable to the contributions made in 2007 and 2008.

T is the employer within the meaning of § 3401(d)(1) for Federal income tax withholding purposes for all years with respect to *A*'s wages resulting from *A*'s interest in *T*. Thus, *T* is liable for Federal income tax withholding on $330,000 in wages paid to *A* for 2009, and *T* is liable for Federal income tax withholding on $120,000 in wages paid to *A* for 2010. *X* is not liable for any Federal income tax withholding in connection with the contributions to *T*.

HOLDING

Income and Deductions. When an employer contributes to a nonexempt employees' trust on behalf of highly compensated employee participants, a participant includes in gross income as compensation under § 402(b)(4)(A) the participant's vested accrued benefit (other than the participant's investment in the contract) as of the end of the taxable year of the trust ending with or within the taxable year of the participant. Provided that the separate account rule of § 404(a)(5) is satisfied, the employer is entitled to deduct a contribution made to the trust on behalf of a participant in the taxable year in which amounts attributable to the contribution are includible in the participant's income, to the extent the contribution otherwise meets the requirements for deductibility. The trust is taxed as a trust under § 641. Because the separate share rule of § 663(c) applies to the trust, the trust is entitled to deduct distributions made to a participant to the extent the distributions do not exceed the distributable net income allocable to the participant's separate share of the trust.

FICA and FUTA. When an employer contributes to a nonexempt employees' trust on behalf of a highly compensated employee, the FICA and FUTA taxation of such contributions depends on whether the employee's interest in the contribution is vested at the time of contribution. If the contribution is vested at the time of contribution, then the amount of the contribution is subject to FICA and FUTA taxes at the time of contribution. The employer is liable for the payment of FICA and FUTA taxes on such amounts. If the contribution is not vested at the time of contribution, then the amount of the contribution and the earnings thereon are subject to FICA and FUTA taxation at the time of vesting. With respect to contributions and earnings thereon that become vested after the date of contribution, the nonexempt employees' trust is considered the employer under

§ 3401(d)(1) with respect to such amounts as they become vested.

Income Tax Withholding. With respect to an employee described in § 402(b)(4)(C), whose gross income is determined under § 402(b)(4)(A), wages for Federal income tax withholding purposes are determined in the same way gross income is determined under § 402(b)(4)(A). Such wages are in the amount of the employee's vested accrued benefit (other than the employee's investment in the contract) on the last day of the taxable year of the nonexempt employees' trust and are treated as paid for Federal income tax withholding purposes on that same date. The nonexempt employees' trust is the employer within the meaning of § 3401(d)(1) with respect to the highly compensated employee whose gross income is determined under § 402(b)(4)(A), regardless of whether contributions made for the benefit of the employee are vested at the time of contribution. Thus, the employees' trust is responsible for all Federal income tax withholding with respect to such wages paid to the employee. Distributions of benefits from the nonexempt employees' trust to the employee or for the employee's benefit are included in determining the vested accrued benefit of the employee at the end of the trust's taxable year, which is subject to Federal income tax withholding at the end of the trust's taxable year.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 74–299 is amplified.

DRAFTING INFORMATION

The principal authors of this revenue ruling are William C. Schmidt and Alfred G. Kelley of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Mr. Schmidt at (202) 622–6030 (not a toll-free call), Mr. Kelley at (202) 622–6040 (not a toll-free call), or Bradford R. Poston of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622–3060 (not a toll-free call).

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

A revenue ruling provides guidance concerning the deduction of contributions to a nonexempt employees' trust. See Rev. Rul. 2007-48, page 129.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–4: Economic performance.

A revenue ruling that holds that an arrangement that provides for the reimbursement of believed-to-be inevitable future cost does not involve the requisite insurance risk for purposes of determining (i) whether the amount paid for the arrangement is deductible as an insurance premium and (ii) whether the assuming entity may account for the arrangement as an 'insurance contract' for purposes of subchapter L of the Code. Stakeholders are asked to comment on the application of the rationale of the revenue ruling outside of its facts. See Rev. Rul. 2007-47, page 127.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, etc.

This revenue procedure sets forth procedures for issuing determination letters and rulings on the exempt status of organizations under sections 501 and 521 of the Internal Revenue Code. These procedures also apply to revocation and modification of determination letters or rulings, and provides guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under section 7428 of the Code. See Rev. Proc. 2007-52, page 222.

Section 661.—Deduction for Estates and Trusts Accumulating Income or Distributing Corpus

A revenue ruling provides guidance concerning the deduction of distributions from a nonexempt employees' trust. See Rev. Rul. 2007-48, page 129.

Section 831.—Tax on Insurance Companies Other Than Life Insurance Companies

26 CFR 1.831–3: Tax on insurance companies (other than life or mutual), mutual marine insurance companies, mutual fire insurance companies issuing perpetual policies, and mutual fire and flood insurance companies operating on the basis of premium deposits; taxable years beginning after December 31, 1962.

A revenue ruling that holds that an arrangement that provides for the reimbursement of believed-to-be inevitable future cost does not involve the requisite insurance risk for purposes of determining (i) whether the amount paid for the arrangement is deductible as an insurance premium and (ii) whether the assuming entity may account for the arrangement as an 'insurance contract' for purposes of subchapter L of the Code. Stakeholders are asked to comment on the application of the rationale of the revenue ruling outside of its facts. See Rev. Rul. 2007-47, page 127.

Section 3121.—Definitions

A revenue ruling provides guidance concerning when amounts contributed to a nonexempt employees' trust constitute wages. See Rev. Rul. 2007-48, page 129.

Section 3306.—Definitions

A revenue ruling provides guidance concerning when amounts contributed to a nonexempt employees' trust constitute wages. See Rev. Rul. 2007-48, page 129.

Section 3402.—Income Tax Collected at Source

A revenue ruling provides guidance concerning income tax withholding with respect to amounts included in the income of a participant in a nonexempt employees' trust and concerning who is the employer for employment tax purposes. See Rev. Rul. 2007-48, page 129.

Part III. Administrative, Procedural, and Miscellaneous

Qualified Payment Card Agent Determination

Notice 2007–59

This notice provides a proposed revenue procedure that would supersede Rev. Proc. 2004–42, 2004–2 C.B. 121 (August 2, 2004). In general, Rev. Proc. 2004–42, establishes a procedure for a payment card organization to request a determination that it is a Qualified Payment Card Agent (QPCA) for purposes of the regulations under section 3406 and section 6724 of the Internal Revenue Code. A QPCA may act on behalf of cardholder/payors in soliciting, collecting, and validating merchants' names, taxpayer identification numbers (TINs) and corporate status (collectively referred to as merchant/payee data) and on behalf of merchant/payees in furnishing merchant/payee data to cardholder/payors. Under section 301.6724–1(c) and (e) of the Regulations on Procedure and Administration, cardholder/payors are relieved of certain TIN solicitation requirements for payments made through a QPCA. Section 31.3406(g)–1(f) of the Employment Tax Regulations provides a limited exception from the backup withholding requirements for payments made to certain merchant/payees through a QPCA.

In response to the request in Notice 2005–25, 2005–1 C.B. 827 (April 4, 2005), for recommendations of publication items for the 2005–2006 Guidance Priority List, some businesses subject to the payment card rules and procedures recommended that Rev. Proc. 2004–42 and section 31.3406(g)–1(f) of the regulations be modified to reflect the current electronic business operations of the payment card industry and to permit the use of payment cards by merchant/payees that opt out of the QPCA program. Specifically, they requested the following changes to the procedures in Rev. Proc. 2004–42:

1. Modification of the requirements in section 5.03(1)(b) and (c) of Rev. Proc. 2004–42 (relating to the written notices that payment card organizations are required to provide to merchant/payees and cardholder/payors when obtaining authorizations to act on their behalf) to permit payment card organizations to furnish the notices electronically.

2. Further modification of the requirements in section 5.03(1)(b) and (c) to allow payment card organizations to include the notification of important tax information either on the outside of the envelope containing the written notices or on the subject line of the electronic communication through which the notice is furnished.

3. Modification of the requirements in section 6.04 (relating to merchant/payee data reports) to provide specific authority for furnishing the merchant/payee data report electronically, including by posting on a secure website.

4. Modification of the content of the written notice required by section 5.03(1)(c) (relating to the notice that payment card organizations are required to provide to merchant/payees) to eliminate the requirement that the notice inform merchant/payees that they will be treated as participants in the QPCA program if they continue to accept the organization's payment card. Instead, require that the notice inform merchant/payees that they may opt out of the QPCA program by completing and returning a written statement to the payment card organization and that they may continue to accept the organization's payment card even if they opt out of the QPCA program.

The Service and Treasury Department agree that it is appropriate to modify the requirements of Rev. Proc. 2004–42 and the regulations to reflect the current electronic business operations of the payment card industry. Proposed amendments to the regulations under section 3406 would authorize electronic furnishing of notifications regarding payee status and participation in the QPCA program if certain conditions are satisfied. In addition, the proposed revenue procedure set forth as an attachment to this notice would adopt the first and second recommendations regarding the electronic furnishing of notices. The proposed revenue procedure also responds to the third recommendation by authorizing the electronic furnishing of merchant/payee data reports if both the cardholder/payor and the merchant/payee consent.

The Service and the Treasury Department also agree that a merchant/payee that does not want to participate in the QPCA program should be allowed to opt out of the program by completing and returning a written statement to the payment card organization and should be permitted to continue accepting the payment card even if it opts out of the QPCA program. The proposed revenue procedure would make this change.

Although QPCAs would not act on behalf of nonparticipating payees in furnishing payee data to cardholders, the Service and the Treasury Department have concluded that a QPCA should be required to furnish certain information to cardholders that use the QPCA's card to make reportable payments to nonparticipating payees. Specifically, the QPCA should be required to inform the cardholder that the payee is not a participant in the QPCA program and is not a qualified payee. Proposed amendments to the regulations under section 3406 would adopt this rule. In addition, the proposed revenue procedure would change the content of the written notice that payment card organizations are required to provide to merchant/payees so that the content is consistent with the proposed regulations relating to payees that opt out of the QPCA program.

The Service requests comments on the proposed revenue procedure. Written comments must be received by September 24, 2007. Comments should be submitted to: CC:PA:LPD:PR (NOT–2007–59), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, comments may be hand delivered between the hours of 8 am and 4 pm to CC:PA:LPD:PR (NOT–2007–59), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC. Comments may also be transmitted electronically via the following email address: *Notice.Commments@irscounsel.treas.gov*.

Please include "Notice 2007–59" in the subject line of any electronic communication.

For further information regarding this notice, contact Michael Hara of the Office of Associate Chief Counsel (Procedure and Administration). Mr. Hara may be contacted at (202) 622–4910 (not a toll-free call).

APPENDIX
(PROPOSED REVENUE PROCEDURE)

SECTION 1. IN GENERAL

This revenue procedure modifies the procedures set forth in Rev. Proc. 2004–42, 2004–2 C.B. 121 (August 2, 2004). Rev. Proc. 2004–42 established a procedure for a payment card organization to request a determination that it is a Qualified Payment Card Agent (QPCA) for purposes of the regulations under section 3406 and section 6724 of the Internal Revenue Code (Code). A QPCA may act on behalf of cardholder/payors in soliciting, collecting, and validating merchants' names, taxpayer identification numbers (TINs) and corporate status (collectively referred to as merchant/payee data) and on behalf of merchant/payees in furnishing merchant/payee data to cardholder/payors. The Regulations on Procedure and Administration relieve cardholder/payors from certain TIN solicitation requirements for payments made through a QPCA. The Employment Tax Regulations provide a limited exception from the backup withholding requirements for payments made to certain merchant/payees through a QPCA.

SECTION 2. SIGNIFICANT CHANGES

The requirements a payment card organization must meet to obtain and retain a QPCA determination are modified as follows:

.01 The written notices that the payment card organization must provide to cardholder/payors and merchant/payees may be mailed (the only option described in Rev. Proc. 2004–42) or furnished electronically. If a notice is furnished electronically, a notification that important tax and privacy information is being provided must be included on the subject line of the electronic communication through which the notice is furnished.

.02 The written notices provided to merchant/payees will no longer be required to inform merchant/payees that they will be treated as participants in the QPCA program if they continue to accept the organization's payment card. Instead, the notice must inform merchant/payees that they may opt out of the QPCA program by completing and returning a written statement to the payment card organization and that they may continue to accept the organization's payment card even if they opt out of the QPCA program.

.03 The reporting requirements are modified to reflect the fact that a QPCA's payment card may be accepted by merchant/payees that have opted out of the QPCA program (nonparticipating merchant/payees). Although QPCAs do not act on behalf of nonparticipating payees in furnishing payee data to cardholders, the QPCA is required to furnish certain information to cardholders that use the QPCA's card to make reportable payments to nonparticipating payees. Specifically, the QPCA is required to inform the cardholder that the payee is not a participant in the QPCA program and is not a qualified payee. In addition, the QPCA must advise the cardholder/payor of the cardholder/payor's obligation to solicit the name and TIN of a nonparticipating merchant/payee to which it makes a reportable payment.

.04 The reporting requirements are also modified to provide specific authority for furnishing the merchant/payee data report electronically, including by posting on a secure website. Electronic reporting is permitted only if both the cardholder/payor and merchant/payee consent by returning the consent form included with the written notice provided by the QPCA.

SECTION 3 . BACKGROUND

.01 *Payment card transactions.* A payment card transaction is a transaction in which a cardholder/payor uses a payment card (as defined in section 5.05 of this revenue procedure) to purchase goods or services and a merchant agrees to accept the payment card as a means of obtaining payment. A payment card organization (as defined in section 5.06 of this revenue procedure) sets the standards and provides the mechanism for effecting the payment.

.02 *Reporting requirements.* In general, section 6041 of the Code requires a person engaged in a trade or business and making a payment in the course of the trade or business of $600 or more during a calendar year of fixed or determinable income to file an information return with the Internal Revenue Service (IRS) and to furnish an information statement to the payee. Section 1.6041–3(p) of the Income Tax Regulations provides exceptions to these requirements, including, for example, exceptions for payments made to a payee that is a corporation. Section 6041A of the Code imposes similar requirements with respect to payments of remuneration for services and direct sales.

Section 6109(a)(2) of the Code provides that any payee, with respect to whom a return is required to be made by another person or whose identifying number is required to be shown on a return of another person, must furnish to the other person the identifying number prescribed for securing the proper identification of the payee. Section 6109(a)(3) provides that any person required to make a return with respect to a payee must ask the payee for the identifying number prescribed for securing the proper identification of the payee and must include that number in the return.

.03 *Backup withholding.* Section 3406(a)(1) requires a payor to withhold on reportable payments (as defined in section 3406(b)(1)) if the payee does not provide a TIN to the payor in the manner required, if the Secretary notifies the payor that the TIN furnished by the payee is incorrect, or if certain other circumstances exist. Section 3406(i) provides that the Secretary shall prescribe the regulations necessary or appropriate to carry out the purposes of section 3406.

Section 31.3406(j)–1 of the Employment Tax Regulations provides that the Commissioner has the authority to establish TIN matching programs through revenue procedures or other appropriate guidance. Under the regulations, a payor or a payor's authorized agent may participate in a TIN matching program that permits the payor or authorized agent to contact the IRS with respect to the TIN furnished by a payee before the payor files an information return for reportable payments

to the payee. The regulations further provide that the IRS will inform the payor or the payor's authorized agent whether or not the name/TIN combination furnished by the payee matches a name/TIN combination maintained for the TIN matching program. Revenue Procedure 2003–9, 2003–1 C.B. 516, describes the procedures for participation in the IRS TIN Matching Program.

Section 31.3406(g)–1(f) of the Employment Tax Regulations provides that the backup withholding requirements of section 3406 do not apply to payments made through a QPCA if the payments are made to a qualified payee or during a grace period. Section 31.3406(g)–1(f)(3) requires a QPCA to notify the cardholder/payor when payments are made to a merchant/payee who is not a qualified payee. Proposed amendments to these regulations would require a QPCA to notify the cardholder/payor when payments are made to a merchant/payee that does not participate in the QPCA program.

.04 *Information reporting penalties and waivers for reasonable cause.* Section 6721 of the Code provides that a payor may be subject to a penalty for failure to file a complete and correct information return. Section 6722 of the Code provides that a payor may be subject to a penalty for failure to furnish a complete and correct information statement to a payee. A failure subject to the section 6721 and section 6722 penalties includes a failure to include correct payee TINs.

Section 6724 provides that the penalties under section 6721 and section 6722 may be waived if the filer shows that the failure was due to reasonable cause and was not due to willful neglect. Under section 301.6724–1(e)(1)(vi)(H) and (f)(5)(vii) of the Regulations on Procedure and Administration, a cardholder/payor in a payment card transaction may establish reasonable cause based on its reliance on a QPCA.

SECTION 4. SCOPE

This revenue procedure applies to payment card organizations acting or seeking to act on behalf of cardholder/payors in soliciting, collecting, and validating merchant/payee data and on behalf of merchant/payees in furnishing merchant/payee data to cardholder/payors.

SECTION 5. DEFINITIONS AND RELATED RULES

The following definitions and related rules apply solely for purposes of this revenue procedure:

.01 *Cardholder.* A cardholder (or cardholder/payor) is the person that agrees to make the payment through the payment card organization. Thus, in the case of a payment card issued to an employee of a person that agrees to make payments through the payment card organization, the employer rather than the employee is the cardholder/payor.

.02 *Merchant.* A merchant (or merchant/payee) is a person that has agreed to accept the payment card issued by the payment card organization as payment for goods and services.

.03 *Merchant/payee data.* Merchant/payee data includes the merchant/payee's name, corporate status, and TIN, and whether the TIN has been validated through the IRS TIN Matching Program.

.04 *Participating payee.* A payee is a participating payee with respect to a reportable payment if—

(1) The written notice described in section 6.03(1)(c) of this revenue procedure was provided to the payee before the date on which the QPCA makes the payment; and

(2) At the time the QPCA makes the payment, the payee has not declined the QPCA's services in the manner prescribed in the written notice.

.05 *Payment card.* A payment card is a card (or an account) issued by a payment card organization to a cardholder/payor which, upon presentation to a merchant/payee, represents an agreement of the cardholder to pay the merchant through the payment card organization.

.06 *Payment card organization.* A payment card organization is an entity that sets the standards and provides the mechanism for effectuating payment between a purchaser and a merchant in a payment card transaction. A payment card organization generally provides this payment mechanism by issuing payment cards, enrolling merchants as authorized acceptors of payment cards for payment for goods or services, and ensuring the system conducts the transactions in accordance with prescribed standards. In any case in which a payment card organization acts through a member, affiliate, or licensee, the action is treated for purposes of this revenue procedure (including this definition) as an action by a payment card organization.

.07 *Qualified Payment Card Agent (QPCA).* A QPCA is a payment card organization that has a current QPCA determination from the IRS. A person acting in its capacity as a QPCA does not act as an agent of the IRS, nor does it have the authority to hold itself out as an agent of the IRS.

SECTION 6. APPLICATION AND REQUIREMENTS FOR QPCA DETERMINATION

.01 *Where to apply for QPCA determination.* A person authorized to act on behalf of a payment card organization may submit a written request for a QPCA determination to the following address:

Internal Revenue Service
1601 Market Street
20th Floor
ATTN: TIN Matching Coordinator
SE:S:CCS:CRC:PC&T
Philadelphia, PA 19107

.02 *Content of QPCA application.* A payment card organization requesting a QPCA determination must include the following in its application:

(1) The name, address, and employer identification number of the payment card organization and a description of its business.

(2) The name of the department or office of the payment card organization that will serve as the information contact.

(3) The name of the department or the names and titles of the officers or employees that will be responsible for the performance of the TIN solicitation activities described in section 7.

(4) A list of the systems, business lines, or card product lines or levels that will be covered by the TIN solicitation activities described in section 7 and that will be covered by a QPCA determination.

(5) An explanation of the account opening procedures and documents the payment card organization uses, or requires its members, affiliates, or licensees to use, to establish merchant account relationships

related to the payment card organization's activities as a QPCA.

(6) The approximate number and the type of merchants (individuals, corporations, etc.) enrolled by the payment card organization.

(7) An explanation of the payment card organization's systems and controls related to the payment card organization's activities as a QPCA for—

(a) Obtaining merchant/payee data (including merchant/payee data provided by reputable third-party sources);

(b) Validating the accuracy of the merchant/payee data;

(c) Ensuring the accuracy and reliability of the merchant/payee data;

(d) Maintaining the merchant/payee data; and

(e) Supplying the merchant/payee data to the cardholder/payor.

.03 *Requirements for QPCA determination.* A payment card organization must meet the following requirements to obtain a QPCA determination:

(1) *Authorization to act on behalf of cardholder/payors and on behalf of merchant/payees.*

(a) The payment card organization must establish that cardholder/payors have authorized it or its members, affiliates, or licensees to act on their behalf in soliciting, collecting, and validating merchants' names and TINs and to assist the cardholders in meeting their information reporting obligations under section 6041 and section 6041A. The payment card organization must also establish that merchant/payees have authorized it or its members, affiliates, or licensees to act on their behalf in furnishing their names, TINs, and corporate status to cardholders and to assist the merchants in meeting their obligations under section 6109(a)(2). To satisfy these requirements, the payment card organization must provide the written notice described in section 6.03(1)(b) to each cardholder/payor and must provide the written notice described in section 6.03(1)(c) to each merchant/payee.

(b) The text of the written notice provided to cardholder/payors must be in bold and conspicuous type, and the notice must include the legend: "Important Tax and Privacy Materials." The notice must state:

> As a cardholder, you may engage in transactions with merchants for which you may be required to file an information return with the Internal Revenue Service. If you are required to file an information return with the Internal Revenue Service reporting a transaction, you must include the amount of the payment, the merchant's name, and the merchant's taxpayer identification number. To assist you in fulfilling these potential information reporting requirements, [insert name of payment card organization] has received [is seeking] approval from the Internal Revenue Service to provide a merchant data service to cardholders. If you accept the merchant data service, [insert name of payment card organization] will act on your behalf, and on behalf of merchants, to solicit, furnish, and validate the merchants' taxpayer identification numbers. A merchant's taxpayer identification number and other merchant data may be provided to you through [insert name of issuer].
>
> If you accept the merchant data service, please be advised that you must maintain the confidentiality of the merchant data provided to you and that you may use it only for purposes of backup withholding and filing information returns with the Internal Revenue Service.
>
> You may decline the merchant data service. If you do not want [insert name of card organization] to provide this service to you, you must complete the enclosed (or attached) form and return it (or a copy) to [insert, as applicable, mailing, facsimile (fax) transmission, and/or e-mail directions].
>
> If [insert name of payment card organization] does not receive your reply by [insert 60 days after date of notice], you will be deemed to have agreed to accept the merchant data service.
>
> If you accept the merchant data service, you will receive the merchant data by U.S. mail unless you complete and return the enclosed (or attached) consent form indicating that you want to receive the merchant data electronically. If you complete the consent form and return it in the enclosed envelope, you will be required to confirm your consent electronically.
>
> You will receive merchant data electronically only for merchants that have consented to their data being provided electronically. You will receive the merchant data by U.S. mail for merchants that have authorized [insert name of payment card organization] to provide their data but do not consent to the data being provided electronically.
>
> Your consent to receive the merchant data electronically will remain in effect until [insert duration of consent]. You may withdraw your consent by contacting [insert name of payment card organization] at [insert address and phone number]. A withdrawal of consent will be effective [insert date, such as date received or subsequent date]. After consenting to receive the merchant data electronically, you may request a paper copy of the data by contacting [insert name of payment card organization] at [insert address and phone number]. A request for a paper copy [insert will or will not] be considered a withdrawal of your consent to receive the merchant data electronically.
>
> In order to receive the merchant data electronically, you will need [insert description of hardware and software to access, print, and retain merchant data]. You will be notified of any change in hardware or software requirements prior to any change that would create a risk that you would not be able to access the merchant data electronically.
>
> [If applicable insert the following: [Insert name of payment card organization] may stop providing the merchant data to you electronically if [insert conditions].
>
> You must inform [insert name of payment card organization] of any changes in your circumstances affecting your ability to receive merchant data electronically.
>
> For more information, contact [insert contact name and phone number].

The notice may be included in the annual (or periodic) agreement, or amendments thereto, between the payment card organization and the cardholder or in a separate document. The notice may be furnished by U.S. mail or electronically. If furnished by U.S. mail, the outside of the envelope in which the written notice is mailed must contain, in bold and conspicuous type, the legend: "Important Tax and Privacy Materials Enclosed." If furnished electronically, the subject line of the electronic communication through which the

notice is furnished must contain, in bold and conspicuous type, the legend: "Important Tax and Privacy Materials Enclosed."

(c) The text of the written notice provided to merchant/payees must be in bold and conspicuous type, and the notice must include the legend: "Important Tax and Privacy Materials." The notice must state:

> As a merchant, you may engage in transactions with cardholders for which cardholders may be required to file an information return with the Internal Revenue Service. If a cardholder is required to file an information return reporting a transaction with you to the Internal Revenue Service, the cardholder must include the amount of the payment, your name, and your taxpayer identification number. To facilitate the exchange of information between you and cardholders, [insert name of payment card organization] has received [is seeking] approval from the Internal Revenue Service to provide a merchant data service to merchants that engage in transactions with cardholders. If you accept the merchant data service, [insert name of payment card organization] will act on your behalf, and on behalf of cardholders, to solicit, furnish, and validate your taxpayer identification number.
>
> If you accept the merchant data service, your name and your taxpayer identification number will be submitted to the Internal Revenue Service for validation against the Internal Revenue Service taxpayer identification number database. Please be advised that if you accept the merchant data service, [insert name of payment card organization] may request that you provide your taxpayer identification number to it or may seek to obtain your taxpayer identification number from a reputable third-party source. If you accept the merchant data service, your taxpayer identification number and corporate status may be provided to cardholders.
>
> Please be aware that [insert name of payment card organization] has advised cardholders who may receive your taxpayer identification number that they must maintain the confidentiality of your information and may use it only for purposes of backup withholding and filing information returns with the Internal Revenue Service.
>
> You may decline the merchant data service. If you do not want [insert name of payment card organization] to validate your name and taxpayer identification number; and to provide your taxpayer identification number and corporate status to cardholders you must complete the enclosed (or attached) form and return it [insert, as applicable, mailing, facsimile (fax) transmission, and/or e-mail directions].
>
> You will be deemed to have agreed to accept the merchant data service with respect to any payments you receive before the date on which [insert name of payment card organization] receives your reply.
>
> [Insert, if applicable: If you decline the merchant data service before January 1, 2008, you should also discontinue accepting the card as a means of obtaining payment until that date. If you continue to accept the [insert name of payment card] as a means for obtaining payment you will be deemed, notwithstanding the return of the enclosed (or attached) form, to have agreed to accept the merchant data service with respect to payments you receive before January 1, 2008.]
>
> If you decline the merchant data service, you may accept the card as a means for obtaining payment [if notice is provided before January 1, 2008, insert: beginning on January 1, 2008]. If you accept the card as a means of obtaining payment after declining the merchant data service, [insert name of payment card organization] is required to report to the cardholder making the payment that you have declined the merchant data service.
>
> Your information (including, if applicable, the information that you have declined the merchant data service) will be provided to cardholders by U.S. mail unless you complete and return the enclosed (or attached) consent form indicating that you want your information to be provided electronically by [insert manner (*e.g.*, e-mail or posting on a secure website) by which information will be provided electronically]. Your consent to your data being provided electronically will remain in effect until [insert duration of consent]. You may withdraw your consent by contacting [insert name of payment card organization] at [insert address and phone number]. A withdrawal of consent will be effective [insert date, such as date received or subsequent date].
>
> For more information, contact [insert contact name and phone number].

The notice may be included in the annual (or periodic) agreement, or amendments thereto, between the payment card organization and the merchant or in a separate document. The notice may be furnished by U.S. mail or electronically. If furnished by U.S. mail, the outside of the envelope in which the written notice is mailed must contain, in bold and conspicuous type, the legend: "Important Tax and Privacy Materials Enclosed." If furnished electronically, the subject line of the electronic communication through which the notice is furnished must contain, in bold and conspicuous type, the legend: "Important Tax and Privacy Materials Enclosed."

(2) *TIN solicitation activities.* The payment card organization must establish that it has undertaken, or demonstrate that it will undertake, the TIN solicitation activities described in section 7.

(3) *Reliability of merchant/payee data.* After obtaining the authorizations required by section 6.03(1), the payment card organization must participate in the IRS TIN Matching Program and must demonstrate, based on the TIN matching results, that its merchant/payee data is sufficiently reliable.

SECTION 7. TIN SOLICITATION ACTIVITIES

.01 *TIN solicitation methods.* A QPCA should solicit merchant/payee TINs in a manner described in section 301.6724–1(e)(1)(i) of the Regulations on Procedure and Administration. Alternatively, a QPCA may obtain merchant/payee TINs from a reputable third-party source.

.02 *Notification and disclosure requirements.* A QPCA must give each merchant/payee for which it acts as agent the written notice described in section 6.03(1)(c) and must give each cardholder/payor for which it acts as agent the written notice described in 6.03(1)(b). In addition, a QPCA must give written notice of its status as a QPCA, and of any change in that status, to any member, affiliate, or licensee that issues payment

cards, as well as to the merchant/payees and cardholder/payors for which it acts as agent.

.03 *TIN Matching participation.* A QPCA must participate in the IRS TIN Matching Program and must match its merchant/payee data relating to reportable payments of participating merchant/payees with IRS within three months after obtaining the merchant/payee's TIN. A QPCA may seek to cure merchant/payee data that has not previously been validated through the IRS TIN Matching Program. The QPCA must transmit only merchant/payee data that has not previously been validated through IRS TIN Matching.

.04 *Providing nonparticipating payee notifications and merchant/payee data to cardholders.* The QPCA must provide cardholder/payors with a report containing notifications required by §31.3406(g)(3)(i)(B) (nonparticipating payee notifications) and merchant/payee data within four months of the date on which the QPCA makes the payment to which the notification or data relates. The report may be provided on a quarterly or other regular basis. The report must include the merchant/payee's name and, if the merchant/payee is not a participating merchant/payee with respect to any reportable payment covered by the report, must include a notification to that effect. If the merchant/payee is a participating payee with respect to all reportable payments covered by the report, the report must also include the merchant/payee's corporate status and TIN, and whether the TIN has been validated through participation in the IRS TIN Matching Program. A QPCA must furnish the report containing nonparticipating payee notifications and merchant/payee data for transactions occurring on or before December 31 of a calendar year no later than January 15 of the following calendar year.

The report may be furnished by U.S mail or electronically (*e.g.*, by e-mail or posting on a secure website). A QPCA may furnish nonparticipating payee notifications and merchant/payee data electronically only if it has obtained the consents described in the written notices required by section 6.03(1) and the consents have not been withdrawn. If the report is posted on a website, the website must protect the privacy of nonparticipating payee notifications and merchant/payee data and allow access to the nonparticipating payee notification or merchant/payee data relating to a payee only to cardholder/payors that have made a reportable payment to that merchant/payee.

SECTION 8. OTHER REQUIREMENTS

.01 *Availability of records.* A payment card organization and its members, affiliates, and licensees must respond to any reasonable IRS request for inspection of any books and records that relate to the operation of TIN solicitation activity, including, but not limited to, reports, memoranda, budgets, and computer printouts. The payment card organization and its members, affiliates, and licensees must allow the IRS reasonable access to the merchant/payee TIN data system, including instruction manuals describing the system.

.02 *Change in information.* The QPCA must promptly notify the IRS of any change in the information described in section 6.

.03 *Confidentiality of information.* For purposes of this revenue procedure, the payment card organization and its members, affiliates, and licensees must maintain the confidentiality of information obtained through the TIN solicitation activities in accordance with the requirements of section 31.3406(f)–1 of the Employment Tax Regulations. Except as permitted under section 31.3406(f)–1, the payment card organization and its members, affiliates, and licensees may not disclose any such information to any person other than the cardholder/payor without prior written consent of the merchant/payee. The IRS will treat all information provided by a QPCA as return information that is confidential under section 6103.

SECTION 9. TERM, RENEWALS, AND TERMINATION

.01 *Term and renewal.* In general, a QPCA determination will be effective for five years from the date of the determination. A QPCA may request a renewal of the QPCA determination by submitting an application for renewal to the IRS no earlier than 12 months and no later than three months before the expiration of the five-year term. In the application for renewal, the QPCA must report any change in the information in the original application. Before renewal of the determination, the IRS may review the QPCA's systems. In addition, the QPCA must demonstrate that the merchant/payee data continues to be reliable. The application for renewal must include the results from participation in the IRS TIN Matching Program during the current five-year term. The IRS will make every effort to issue a decision on a renewal application at least 30 days before the expiration of the current five-year term. In the event that the IRS does not issue a decision on a timely renewal application before the expiration of the existing QPCA determination, the existing determination will remain in effect until the IRS issues a decision on the renewal application.

.02 *Revocation of determination.* The IRS may revoke a QPCA determination before the expiration of its five-year term if the IRS determines, based on the results of the QPCA's participation in the IRS TIN Matching Program, that the merchant/payee data is not reliable or if the payment card organization fails to meet any of the requirements in section 6, 7, or 8. A QPCA may terminate its status as a QPCA upon 60 days written notice to the IRS.

SECTION 10. Rev. Proc. 2004–42 is superseded.

SECTION 11. EFFECTIVE DATE

These procedures are proposed to be effective on the date they are published as a final revenue procedure.

SECTION 12. DRAFTING INFORMATION

The principal author of this revenue procedure is Michael Hara of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue procedure, contact Mr. Hara at (202) 622–4910 (not a toll-free call).

Weighted Average Interest Rates Update

Notice 2007–61

This notice provides guidance as to the corporate bond weighted average interest

rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II).

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for June 2007 is 6.32 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in: Month	Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
July	2007	5.83	5.25 to 5.83

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for June 2007 is 5.20 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2037.

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 877–829–5500 (a toll-free number), between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 202–283–9703. Mr. Montanaro may be reached at 202–283–9714. The telephone numbers in the preceding sentences are not toll-free.

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26 CFR 601.202: Closing agreements.

Rev. Proc. 2007–49

SECTION 1. PURPOSE

.01 This revenue procedure describes the consequence to a sponsor or practitioner maintaining a pre-approved plan that submits its plan for review after the established deadline in section 16 of Rev. Proc. 2007–44, 2007–28 I.R.B. 54.

.02 This revenue procedure also modifies the streamlined VCP application procedure for failures set forth in section 11.01 and Appendix F of Rev. Proc. 2006–27, 2006–1 C.B. 945.

SECTION 2. BACKGROUND

.01 Rev. Proc. 2006–27 sets forth the Employee Plans Compliance Resolution System ("EPCRS"), a comprehensive system of correction programs that permits plan sponsors to correct qualification failures and thereby preserve their plans' tax-favored status. The components of EPCRS are the Self-Correction Program ("SCP"), the Voluntary Correction Program ("VCP"), and the Audit Closing Agreement Program ("Audit CAP"). Under SCP, a plan sponsor may correct certain qualification failures, including operational failures described in Appendix B of that procedure as being correctable by plan amendment. Under VCP, a Plan Sponsor, before audit, may submit to the Service and receive approval for correction of qualification failures. Under Audit CAP, a plan sponsor may correct qualification failures that are identified on audit.

.02 Rev. Proc. 2005–16, 2005–1 C.B. 674, sets forth the Service's procedures for issuing opinion and advisory letters regarding the acceptability under §§ 401 and 403(a) of the Internal Revenue Code of the form of pre-approved plans (*i.e.*, master and prototype (M&P) and volume submitter (VS) plans).

.03 An application for an opinion letter for an M&P plan may be submitted by a sponsor (as defined in Rev. Proc. 2005–16) who satisfies the requirements of section 4.07 of Rev. Proc. 2005–16. In the alternative, an application for an opin-

ion letter may be submitted by an M&P Mass Submitter (as defined in section 4.08 of Rev. Proc. 2005–16) or a word-for-word identical adopter or minor modifier adopter of a plan of an M&P Mass Submitter as provided in section 4.08 of Rev. Proc. 2005–16.

.04 An application for an advisory letter for a VS plan may be submitted by a VS practitioner (as defined in Rev. Proc. 2005–16) who satisfies the requirements of section 13.04 of Rev. Proc. 2005–16. In the alternative, an application for an advisory letter may be submitted by a VS Mass Submitter (as defined in section 13.05 of Rev. Proc. 2005–16) or a word-for-word adopter of a plan of a VS Mass Submitter as provided in section 13.05 of Rev. Proc. 2005–16.

.05 Rev. Proc. 2007–44 sets forth a system of cyclical remedial amendment periods under § 401(b) for pre-approved plans and individually designed plans. Under this system, every pre-approved plan generally has a regular six-year remedial amendment/approval cycle. As a result, sponsors and practitioners generally need to apply for new opinion or advisory letters only once every six years.

.06 Section 16.02 of Rev. Proc. 2007–44 provides that sponsors and practitioners maintaining pre-approved plans generally have until January 31st of the calendar year following the opening of the six-year remedial amendment cycle to submit applications for opinion or advisory letters. This deadline also applies to word-for-word identical adopters and minor modifier placeholder applications.

.07 Section 16.03 of Rev. Proc. 2007–44 provides that when the review of a cycle for pre-approved plans has neared completion (after approximately a two-year review process), the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans. This will be a uniform date that will apply to all adopting employers. Depending upon the length of the review process, it is expected that this date will give virtually all employers approximately a two-year window to adopt their updated plans.

.08 Section 17.01 of Rev. Proc. 2007–44 provides that an employer's plan will be treated as a pre-approved plan and therefore eligible for a six-year amendment/approval cycle if the employer's plan meets the requirements of section 17.01(1) of Rev. Proc. 2007–44 and the sponsor or practitioner maintaining the pre-approved plan timely submits an opinion or advisory letter application in accordance with section 17.01(2) of Rev. Proc. 2007–44.

SECTION 3. VCP STREAMLINED SUBMISSION PROCEDURE FOR THE FAILURE TO ADOPT TIMELY CERTAIN AMENDMENTS

Section 11.01 of Rev. Proc. 2006–27 is supplemented to provide the following. The Appendix F format should not be modified. In addition, since it is a document that is executed by the Internal Revenue Service, it should not be submitted under the letterhead of the plan sponsor or the plan sponsor's authorized representative. The failure to provide the information required by Appendix F in the format provided for by Appendix F may result in the application being returned as an incomplete submission.

SECTION 4. LATE SUBMISSIONS FOR OPINION OR ADVISORY LETTERS

.01 Applications for opinion or advisory letters submitted by sponsors and practitioners, including word-for-word identical adopters and minor modifier placeholder applications, are generally processed in the order received. If a sponsor or practitioner of an M&P or VS plan with a valid opinion or advisory letter from the immediately preceding six-year cycle (or, for the initial six-year cycle, a valid opinion or advisory letter for GUST[1]) submits an application for an opinion or advisory letter after the scheduled due date provided for in section 16 of Rev. Proc. 2007–44 (or in the predecessor procedure, Rev. Proc. 2005–66, 2005–2 C.B. 509) or in any successor revenue procedure, then the review of the plan will be delayed and may not be completed by the time the review of timely submitted pre-approved plans is completed for other sponsors and practitioners (approximately two years). As a result, an employer adopting such plan may have less than two years to adopt the late submitted pre-approved plan (*i.e.*, less time than an employer adopting a pre-approved plan that had been submitted by the deadline set forth in section 16 of Rev. Proc. 2007–44).

.02 Any application for an opinion or advisory letter submitted by sponsors and practitioners, including word-for-word identical adopters and minor modifier placeholder applications, should be mailed to the address listed in section 20 of Rev. Proc. 2005–16 and include the appropriate user fee referred to in section 6.05 or 6.06 of Rev. Proc. 2007–8, 2007–1 I.R.B. 230.

SECTION 5. EFFECTIVE DATE

Section 3 of this revenue procedure is effective August 28, 2007. Section 4 of this revenue procedure applies to all late submissions for opinion or advisory letters made after January 31, 2006.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–27 is modified.

DRAFTING INFORMATION

The principal author of this revenue procedure is Avaneesh Bhagat of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday or Mr. Bhagat at *RetirementPlanQuestions@irs.gov.*

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[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

Use this Revenue Procedure to prepare Tax Year *2007* and prior year information returns for submission to Internal Revenue Service (IRS) using any of the following:

- Electronic Filing
- Tape Cartridge

Caution to filers:

Please read this publication carefully. Persons or businesses required to file information returns electronically or magnetically may be subject to penalties for failure to file or include correct information if they do not follow the instructions in this Revenue Procedure.

IMPORTANT NOTES:

IRS/ECC-MTB now offers an Internet connection at http://fire.irs.gov for electronic filing. The Filing Information Returns Electronically (FIRE) System will be down from 2 p.m. E.S.T. Dec. 20, 2007, through Jan. 2, 2008 for upgrading. It is not operational during this time for submissions. The FIRE System does not provide fill-in forms for information returns.

IRS/ECC-MTB no longer accepts 3½-inch diskettes for filing information returns.

Tax year 2007 is the last year IRS/ECC-MTB will accept tape cartridges for the filing of information returns. Tape cartridges must be received by DECEMBER 1, 2008 in order to be processed for the current year. After December 1, 2008, electronic filing will be the ONLY acceptable method to file information returns at ECC-MTB.

Rev. Proc. 2007–51

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Part A. General

Revenue Procedures are generally revised annually to reflect legislative and form changes. Comments concerning this Revenue Procedure, or suggestions for making it more helpful, can be addressed to:

Internal Revenue Service
Enterprise Computing Center — Martinsburg
Attn: Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

Sec. 1. Purpose

.01 The purpose of this Revenue Procedure is to provide the specifications for filing Forms 1098, 1099, 5498, and W–2G with IRS electronically through the IRS FIRE System or magnetically, using IBM 3480, 3490, 3490E, 3590, or 3590E tape cartridges. This Revenue Procedure must be used for the preparation of Tax Year *2007* information returns and information returns for tax years prior to *2007* ***filed beginning January 1, 2008. Tape cartridge files must be received by December 1, 2008 in order to be processed. After December 1, 2008 only electronic files are acceptable.*** Specifications for filing the following forms are contained in this Revenue Procedure.

- **(a)** Form 1098, Mortgage Interest Statement
- **(b)** Form 1098–C, Contributions of Motor Vehicles, Boats, and Airplanes
- **(c)** Form 1098–E, Student Loan Interest Statement
- **(d)** Form 1098–T, Tuition Statement
- **(e)** Form 1099–A, Acquisition or Abandonment of Secured Property
- **(f)** Form 1099–B, Proceeds From Broker and Barter Exchange Transactions
- **(g)** Form 1099–C, Cancellation of Debt
- **(h)** Form 1099–CAP, Changes in Corporate Control and Capital Structure
- **(i)** Form 1099–DIV, Dividends and Distributions
- **(j)** Form 1099–G, Certain Government Payments
- **(k)** Form 1099–H, Health Coverage Tax Credit (HCTC) Advance Payments
- **(l)** Form 1099–INT, Interest Income
- **(m)** Form 1099–LTC, Long-Term Care and Accelerated Death Benefits
- **(n)** Form 1099–MISC, Miscellaneous Income
- **(o)** Form 1099–OID, Original Issue Discount
- **(p)** Form 1099–PATR, Taxable Distributions Received From Cooperatives
- **(q)** Form 1099–Q, Payments From Qualified Education Programs (Under Sections 529 and 530)
- **(r)** Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- **(s)** Form 1099–S, Proceeds From Real Estate Transactions
- **(t)** Form 1099–SA, Distributions From an HSA, Archer MSA, or Medicare Advantage MSA

(u) Form 5498, IRA Contribution Information
(v) Form 5498–ESA, Coverdell ESA Contribution Information
(w) Form 5498–SA, HSA, Archer MSA, or Medicare Advantage MSA Information
(x) Form W–2G, Certain Gambling Winnings

.02 All data received at IRS/ECC-MTB for processing will be given the same protection as individual income tax returns (Form 1040). IRS/ECC-MTB will process the data and determine if the records are formatted and coded according to this Revenue Procedure.

.03 Specifications for filing Forms W–2, Wage and Tax Statement, electronically are **only** available from the Social Security Administration (SSA). Filers can call 1–800–SSA–6270 to obtain the telephone number of the SSA Employer Service Liaison Officer for their area.

.04 IRS/ECC-MTB does **not** process Forms W–2. Paper **and/or** electronic filing of Forms W–2 must be sent to SSA. IRS/ECC-MTB does, however, process waiver requests (Form 8508) and extension of time to file requests (Form 8809) for Forms W–2 as well as requests for an extension of time to provide the employee copies of Forms W–2.

.05 Generally, the box numbers on the paper forms correspond with the amount codes used to file electronically/magnetically; however, if discrepancies occur, the instructions in this Revenue Procedure must be followed.

.06 This Revenue Procedure also provides the requirements and specifications for electronic or tape cartridge filing under the Combined Federal/State Filing Program.

.07 The following Revenue Procedures and publications provide more detailed filing procedures for certain information returns:
(a) *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G* and individual form instructions.
(b) Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W–2G, and 1042–S.
(c) Publication 1239, Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically or Magnetically
(d) Publication 1187, Specifications for Filing Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically

.08 This Revenue Procedure supersedes Rev. Proc. 2006–33 published as Publication 1220 (Rev. 10–2006), Specifications for Filing Forms 1098, 1099, 5498, and W–2G Electronically or Magnetically.

Sec. 2. Nature of Changes — Current Year (Tax Year *2007*)

.01 In this publication, all pertinent changes for Tax Year *2007* are emphasized by the use of *italics*. Portions of text that require special attention are in boldface text. Filers are always encouraged to read the publication in its entirety.

a. General

(1) ECC-MTB no longer accepts 3½-inch diskettes for the filing of information returns.
(2) **Tax Year 2007 will be the last year ECC-MTB accepts tape cartridges.** Due to processing deadlines, tape cartridges must be received by December 1, 2008 in order to be processed for the current year. After December 1, 2008, the only acceptable method of filing information returns with ECC-MTB will be electronically through the FIRE System.
(3) Test procedures have been eliminated from Part A since tape cartridges will not be acceptable after December 1, 2008. Electronic filing specifications, Part B, Sec. 4 details testing procedures for electronic files.
(4) Form 8809, Application for Extension of Time To File Information Returns, is available as a fill-in form on the FIRE System and is highly encouraged in lieu of the paper Form 8809. (See Part E, Sec. 1.)

.02 Programming Changes

a. Programming Changes — Transmitter "T" Record

(1) For all Forms, Payment Year, Field Positions 2 – 5, must be incremented to update the four-digit reporting year (2006 to 2007), unless reporting prior year data.

b. Programming Changes — Payer "A" Record

(1) For all Forms, Payment Year, Field Positions 2 – 5, must be incremented to update the four-digit reporting year (2006 to 2007), unless reporting prior year data.
(2) For Form 1098, Amount Code 4 was changed to Mortgage Insurance Premiums. Amount Code 5 was added for Filer's Use.
(3) Three fields were deleted from the Payer 'A' Record and are no longer required. The deleted fields are Original File Indicator, position 48, Replacement File Indicator, position 49, and Correction File Indicator, position 50. Positions 48–50 are now blank.

c. Programming Changes — Payee "B" Record

(1) For all Forms, Payment Year, Field Positions 2 – 5, must be incremented to update the four-digit reporting year (2006 to 2007), unless reporting prior year data.

(2) Form 1098–T, Method of Reporting Indicator, position 550, was simplified. A single indicator of '1' is used to indicate if the method of reporting changed from the previous year. A blank indicates no change occurred.

(3) Form 1099–R, Date of Designated Roth Contribution, position 552–559, changed to First Year of Designated Roth Contribution, positions 552–555. Only the year of the first Roth contribution is required not the complete date.

(4) For Form 1099–R , Distribution Code 'B' may now be used with codes 'P' and '4'.

(5) The state of Utah, state code 49, was added to the Combined Federal/State Filing Program. See Part A, Sec. 12 for the Participating States and Their Codes table.

Sec. 3. Where To File and How to Contact the IRS, Enterprise Computing Center — Martinsburg

.01 All information returns filed electronically or magnetically are processed at IRS/ECC-MTB. Files containing information returns and requests for IRS electronic and tape cartridge filing information should be sent to the following address:

IRS-Enterprise Computing Center — Martinsburg
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

.02 All requests for an extension of time to file information returns with IRS/ECC-MTB filed on Form 8809 or request for an extension to provide recipient copies, and requests for undue hardship waivers filed on Form 8508 should be sent to the following address:

IRS-Enterprise Computing Center — Martinsburg
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

.03 The telephone numbers for tape cartridge inquiries or electronic submissions are:

Information Reporting Program Customer Service Section

TOLL-FREE 1–866–455–7438 or outside the U.S. 1–304–263–8700

email at mccirp@irs.gov

304–267–3367 — TDD

(Telecommunication Device for the Deaf)

304–264–5602 — Fax Machine

Electronic Filing — FIRE System

http://fire.irs.gov

TO OBTAIN FORMS:

1–800–TAX–FORM (1–800–829–3676)

www.irs.gov — IRS website access to forms (See Note.)

Note: Because paper forms are scanned during processing, you cannot use forms printed from the IRS website to file Form 1096, and Copy A of Forms 1098, 1099, or 5498 with the IRS.

.04 The *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G* are included in the Publication 1220 for your convenience. Form 1096 is used only to transmit Copy A of **paper** Forms 1099, 1098, 5498, and W–2G. If filing paper returns, follow the mailing instructions on Form 1096 and submit the paper returns to the appropriate IRS Service Center.

.05 Make requests for paper Forms 1096, 1098, 1099, 5498, and W–2G, and publications related to electronic/magnetic filing by calling the IRS toll-free number **1–800–TAX–FORM (1–800–829–3676) or ordering online from the IRS website at** www.irs.gov.

.06 Questions pertaining to magnetic media or internet filing of Forms W–2 **must** be directed to the Social Security Administration (SSA). Filers can call 1–800–772–6270 to obtain the phone number of the SSA Employer Service Liaison Officer for their area.

.07 Payers **should not** contact IRS/ECC-MTB if they have received a penalty notice and need additional information or are requesting an abatement of the penalty. A penalty notice contains an IRS representative's name and/or telephone number for contact purposes; or the payer may be instructed to respond in writing to the address provided. IRS/ECC-MTB does **not** issue penalty notices and does **not** have the authority to abate penalties. For penalty information, refer to the Penalties section of the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G.*

.08 A taxpayer or authorized representative may request a copy of a tax return, including Form W–2 filed with a return, by submitting Form 4506, Request for Copy of Tax Return, to IRS. This form may be obtained by calling **1–800–TAX–FORM (1–800–829–3676) or by downloading from the IRS website at www.irs.gov.** For any questions regarding this form, call 1–800–829–1040.

.09 The Information Reporting Program Customer Service Section (IRP/CSS), located at IRS/ECC-MTB, answers electronic/tape cartridge, paper filing, and tax law questions from the payer community relating to the correct preparation and filing of business information returns (Forms 1096, 1098, 1099, 5498, 8027, and W–2G). IRP/CSS also answers questions relating to the electronic/tape cartridge filing of Forms 1042–S and the tax law criteria and paper filing instructions for Forms W–2 and W–3. Inquiries dealing with backup withholding and reasonable cause requirements due to missing and incorrect taxpayer identification numbers are also addressed by IRP/CSS. Assistance is available year-round to payers, transmitters, and employers nationwide, Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern Time, by calling toll-free **1–866–455–7438** or via email at mccirp@irs.gov. **Do not include SSNs or EINs in emails or in attachments since this is not a secure line.** The Telecommunications Device for the Deaf **(TDD)** toll number is **304–267–3367.** Call as soon as questions arise to avoid the busy filing seasons at the end of January and February. Recipients of information returns (payees) should continue to contact 1–800–829–1040 with any questions on how to report the information returns data on their tax returns.

.10 IRP/CSS cannot advise filers where to send state copies of paper forms. Filers must contact the Tax Department in the state where the recipient resides to obtain the correct address and filing requirements.

.11 Form 4419, Application for Filing Information Returns Electronically, Form 8809, Application for Extension of Time To File Information Returns, and Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically, may be faxed to IRS/ECC-MTB at 304–264–5602. Form 4804, Transmittal of Information Returns Reported Magnetically, **must** always be included with media shipments.

Sec. 4. Filing Requirements

.01 The regulations under section 6011(e)(2)(A) of the Internal Revenue Code provide that any person, including a corporation, partnership, individual, estate, and trust, who is required to file 250 or more information returns must file such returns electronically/magnetically. **The 250* or more requirement applies separately for each type of return and separately to each type of corrected return.**

***Even though filers may submit up to 249 information returns on paper, IRS encourages filers to transmit those information returns electronically or magnetically.**

.02 All filing requirements that follow apply individually to each reporting entity as defined by its separate Taxpayer Identification Number (TIN), which may be either a Social Security Number (SSN), Employer Identification Number (EIN), or Individual Taxpayer Identification Number (ITIN). For example, if a corporation with several branches or locations uses the same EIN, the corporation must aggregate the total volume of returns to be filed for that EIN and apply the filing requirements to each type of return accordingly.

.03 Payers who are required to submit their information returns on magnetic media may choose to submit their documents by electronic filing. Payers, who submit their information returns electronically by March 31, *2008*, are considered to have satisfied the magnetic media filing requirements.

.04 IRS/ECC-MTB has one method for filing information returns electronically; see Part B.

.05 The following requirements apply separately to both originals and corrections filed electronically/magnetically:

1098 1098–C 1098–E 1098–T 1099–A 1099–B 1099–C 1099–CAP 1099–DIV 1099–G 1099–H 1099–INT 1099–LTC 1099–MISC 1099–OID 1099–PATR 1099–Q 1099–R 1099–S 1099–SA 5498 5498–ESA 5498–SA W–2G	**250 or more of any** of these forms require electronic or magnetic media filing with IRS. These are stand-alone documents and may not be aggregated for purposes of determining the 250 threshold. For example, if you must file 100 Forms 1099–B and 300 Forms 1099–INT, Forms 1099–B need not be filed electronically or magnetically since they do not meet the threshold of 250. However, Forms 1099–INT must be filed electronically or magnetically since they meet the threshold of 250.

.06 The above requirements do not apply if the payer establishes undue hardship (See Part E, Sec. 5).

Sec. 5. Vendor List

.01 IRS/ECC-MTB prepares a list of vendors who support electronic or tape cartridge filing. The Vendor List (Pub. 1582) contains the names of service bureaus that will produce or submit files for electronic filing or on tape cartridges. It also contains the names of vendors who provide software packages for payers who wish to produce electronic files or tape cartridges on their own computer systems. This list is compiled as a courtesy and in no way implies IRS/ECC-MTB approval or endorsement.

.02 If filers engage a service bureau to prepare files on their behalf, the filers must not report duplicate data, which may cause penalty notices to be generated.

.03 The Vendor List, Publication 1582, is updated periodically. The most recent revision is available on the IRS website at **www.irs.gov**. For an additional list of software providers, log on to www.irs.gov and go to the Approved IRS e-file for Business Providers link.

.04 A vendor, who offers a software package, or has the capability to electronically file information returns, or has the ability to produce tape cartridges for customers, and who would like to be included in Publication 1582 must submit a letter or email to IRS/ECC-MTB. The request should include:

- **(a)** Company name
- **(b)** Address (include city, state, and ZIP code)
- **(c)** Telephone and FAX number (include area code)
- **(d)** Email address
- **(e)** Contact person
- **(f)** Type(s) of service provided (e.g., service bureau and/or software)
- **(g)** Type(s) of media offered (e.g., tape cartridge, or electronic filing)
- **(h)** Type(s) of return(s)

Sec. 6. Form 4419, Application for Filing Information Returns Electronically

.01 Transmitters are required to submit Form 4419, Application for Filing Information Returns Electronically, to request authorization to file information returns with IRS/ECC-MTB. A single Form 4419 should be filed no matter how many types of returns the transmitter will be submitting electronically. For example, if a transmitter plans to file Forms 1099–INT, one Form 4419 should be submitted. If, at a later date, another type of form (Forms 1098, 1099, 5498 and W–2G) will be filed, the transmitter should not submit a new Form 4419.

Note: EXCEPTIONS – An additional Form 4419 is required for filing each of the following types of returns: Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, and Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. See the back of Form 4419 for detailed instructions.

.02 Tape cartridge and electronically filed returns may not be submitted to IRS/ECC-MTB until the application has been approved. Please read the instructions on the back of Form 4419 carefully. Form 4419 is included in the Publication 1220 for the filer's use. This form may be photocopied. Additional forms may be obtained by calling **1–800–TAX–FORM (1–800–829–3676).** The form is also available on the IRS website at **www.irs.gov**.

.03 Upon approval, a five-character alpha/numeric Transmitter Control Code (TCC) will be assigned and included in an approval letter. The TCC **must** be coded in the Transmitter "T" Record. IRS/ECC-MTB uses the TCC to identify payer/transmitters and to track their files through the processing system. The same TCC can be used regardless of the method of filing. For example, a payer may send their production data on a tape cartridge and then later file a correction file electronically. The same TCC can be used for each filing.

.04 IRS/ECC-MTB encourages transmitters who file for multiple payers to submit one application and to use the assigned TCC for all payers. While not encouraged, multiple TCCs can be issued to payers with multiple TINs. Transmitters cannot use more than one TCC in a file. Each TCC must be reported in separate transmissions if filing electronically or on separate media if filing magnetically.

.05 If a payer's files are prepared by a service bureau, the payer may not need to submit an application to obtain a TCC. Some service bureaus will produce files, code their own TCC in the file, and send it to IRS/ECC-MTB for the payer. Other service bureaus will prepare the file and return the file to the payer for submission to IRS/ECC-MTB. These service bureaus may require the payer to obtain a TCC, which is coded in the Transmitter "T" Record. Payers should contact their service bureaus for further information.

.06 Form 4419 may be submitted anytime during the year; however, it **must** be submitted to IRS/ECC-MTB at least 30 days before the due date of the return(s) for current year processing. This allows IRS/ECC-MTB the time necessary to process and respond to applications. Form 4419 may be faxed to IRS/ECC-MTB at 304–264–5602. In the event that computer equipment or software is not compatible with IRS/ECC-MTB, a waiver may be requested to file returns on paper documents (See Part E, Sec. 5).

.07 Once a transmitter is approved to file electronically/magnetically, it is not necessary to reapply **unless**:

- **(a)** The payer has discontinued filing electronically or magnetically for two consecutive years. The payer's TCC may have been reassigned by IRS/ECC-MTB. Payers who know that the assigned TCC will no longer be used, are requested to notify IRS/ECC-MTB so these numbers may be reassigned.
- **(b)** The payer's files were transmitted in the past by a service bureau using the service bureau's TCC, but now the payer has computer equipment compatible with that of IRS/ECC-MTB and wishes to prepare his or her own files. The payer must request a TCC by filing Form 4419.

.08 In accordance with Regulations section 1.6041–7(b), payments by separate departments of a health care carrier to providers of medical and health care services may be reported on separate returns filed electronically or magnetically. In this case, the headquarters will be considered the transmitter, and the individual departments of the company filing reports will be considered payers. A single Form 4419 covering all departments filing electronically should be submitted. One TCC may be used for all departments.

.09 Copies of Publication 1220 can be obtained by downloading from the IRS website at **www.irs.gov.**

.10 If **any** of the information (name, TIN or address) on Form 4419 changes, please notify IRS/ECC-MTB in writing so the IRS/ECC-MTB database can be updated. The email address, mccirp@irs.gov, may be used for basic name and address changes. A change in the method by which information returns are submitted is not information that needs to be updated (e.g., cartridge to electronic). The transmitter should include the TCC in all correspondence.

.11 Approval to file does not imply endorsement by IRS/ECC-MTB of any computer software or of the quality of tax preparation services provided by a service bureau or software vendor.

Sec. 7. Filing of Information Returns Magnetically and Retention Requirements

.01 Form 4804, Transmittal of Information Returns Reported Magnetically, or a computer-generated substitute, must accompany **all** tape cartridge shipments except for replacements, when Form 4804 is not always required (See Part A, Sec. 10).

.02 IRS/ECC-MTB allows for the use of computer-generated substitutes for Form 4804. The substitutes must contain all information requested on the original forms including the affidavit and signature line. Photocopies are acceptable, however, an original signature is required. When using computer-generated forms, be sure to clearly mark the tax year being reported. This will eliminate a telephone communication from IRS/ECC-MTB to verify the tax year.

.03 Form 4804 may be signed by the payer or the transmitter, service bureau, paying agent, or disbursing agent (all hereafter referred to as agent) on behalf of the payer. Failure to sign the affidavit on Form 4804 may delay processing or could result in the files not being processed. An agent may sign Form 4804 if the agent has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law and adds the caption "FOR: (name of payer)."

.04 Although an authorized agent may sign the affidavit, the payer is responsible for the accuracy of Form 4804 and the returns filed. The payer will be liable for penalties for failure to comply with filing requirements.

.05 Current and prior year data may be submitted in the same shipment; however, each tax year must be on separate media, and a separate Form 4804 must be prepared to clearly indicate each tax year.

.06 Filers who have prepared their information returns in advance of the due date are encouraged to submit this information to IRS/ECC-MTB no earlier than January 1 of the year the returns are due. Filers may submit multiple original files by the due date as long as duplicate information is not reported.

.07 Do not report duplicate information. If a filer submits returns electronically or magnetically, identical paper documents must not be filed. This may result in erroneous penalty notices being sent to the recipients.

.08 A self-adhesive external media label, created by the filer, must be affixed to each tape cartridge. For instructions on how to prepare an external media label, refer to Notice 210 in the forms section of this publication.

.09 When submitting files on tape cartridges include the following:

(a) A **signed** Form 4804

(b) External media label (created by filer) affixed to the tape cartridge

(c) IRB Box ______ of ______ labeled on outside of each package

.10 IRS/ECC-MTB will not return media after processing. Therefore, if the transmitter wants proof that IRS/ECC-MTB received a shipment, the transmitter should select a service with tracking capabilities or one that will provide proof of delivery. Shipping containers will not be returned to the filer.

.11 IRS/ECC-MTB will not pay for or accept "Cash-on-Delivery" or "Charge to IRS" shipments of tax information that an individual or organization is legally required to submit.

.12 Payers should retain a copy of the information returns filed with IRS or have the ability to reconstruct the data for at least 3 years from the reporting due date, except:

(a) Retain for 4 years all information returns when backup withholding is imposed.

(b) A financial entity must retain a copy of Form 1099–C, Cancellation of Debt, or have the ability to reconstruct the data required to be included on the return, for at least 4 years from the date such return is required to be filed.

Sec. 8. Due Dates

.01 The due dates for filing paper returns with IRS also apply to tape cartridges. Filing of information returns is on a calendar year basis, except for Forms 5498, 5498–ESA and 5498–SA, which are used to report amounts contributed during or after the calendar year (but not later than April 15). The following due dates will apply to Tax Year *2007*:

Due Dates

Electronic Filing	Tape Cartridge Filing (See Note.)
Forms 1098, 1099, and W–2G Recipient Copy – January 31, 2008 IRS Copy – March 31, 2008	Forms 1098, 1099, and W–2G Recipient Copy – January 31, 2008 IRS Copy – February 28, 2008

Electronic/Tape Cartridge Filing
Forms 5498*, 5498–SA and 5498–ESA IRS Copy – June 2, 2008 Forms 5498 and 5498–SA Participant Copy – June 2, 2008 Form 5498–ESA Participant Copy – April 30, 2008 * Participants' copies of Forms 5498 to furnish fair market value information — January 31, 2008

.02 If any due date falls on a Saturday, Sunday, or legal holiday, the return or statement is considered timely if filed or furnished on the next day that is not a Saturday, Sunday, or legal holiday.

.03 Tape cartridges postmarked by the United States Postal Service (USPS) on or before February 28, 2008, and delivered by United States mail to the IRS/ECC-MTB after the due date, are treated as timely under the "timely mailing as timely filing" rule. **Refer to the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G,* When to File, located in the back of this publication for more detailed information.** Notice 97–26, 1997–1 C.B. 413, provides rules for determining the date that is treated as the postmark date. For items delivered by a non-designated Private Delivery Service (PDS), the actual date of receipt by IRS/ECC-MTB will be used as the filing date. For items delivered by a designated PDS, but through a type of service not designated in Notice 2004–83, 2004–2 C.B. 1030, the actual date of receipt by IRS/ECC-MTB will be used as the filing date. The timely mailing rule also applies to furnishing statements to recipients and participants.

Note: Due to security regulations at ECC-MTB, the Internal Revenue police officers will only accept media from PDSs or couriers from *8:00 a.m. to 3:00 p.m.*, Monday through Friday.

.04 Tape Cartridges must be received by December 1, 2008 in order to be processed for the current year. After December 1, 2008 the only acceptable method of filing information returns with ECC-MTB will be electronically through the FIRE System. See Part B for electronic reporting.

Sec. 9. Replacement Tape Cartridges

Note: Replacement Electronic files are detailed in Part B, Sec. 5.

.01 A replacement is an information return file sent by the filer **at the request of IRS/ECC-MTB** because of errors encountered while processing the filer's original file or correction file. After the necessary changes have been made, the entire file must be returned for processing along with the Media Tracking Slip (Form 9267) which was included in the correspondence from IRS/ECC-MTB. **(See Note.)**

Note: Filers should never send anything to IRS/ECC-MTB marked "Replacement" unless IRS/ECC-MTB has requested a replacement file in writing or via the FIRE System.

.02 Tape cartridge filers will receive a Media Tracking Slip (Form 9267), listing, and letter detailing the reason(s) their media could not be processed. It is imperative that filers maintain backup copies and/or recreate capabilities for their information return files. Open all correspondence from IRS/ECC-MTB immediately.

.03 When possible, sample records identifying errors encountered will be provided with the returned information. It is the responsibility of the transmitter to check the entire file for similar errors.

.04 Before sending replacement media make certain the following items are addressed:

(a) Make the required changes noted in the enclosed correspondence and check entire file for other errors.

(b) Enclose Form 9267, Media Tracking Slip, with your replacement media.

(c) Label your media **"Replacement Data"** and indicate the appropriate Tax Year.

(d) Complete a new Form 4804 **if any of your information has changed.**

.05 Replacement files must be corrected and returned to IRS/ECC-MTB within 45 days from the date of the letter. **(See Note.)** Refer to Part B, Sec. 5, for procedures for files submitted electronically. A penalty for failure to return a replacement file will be assessed if the files are not corrected and returned within the 45 days **or if filers are notified by IRS/ECC-MTB of the need for a replacement file more than two times.** A penalty for intentional disregard of filing requirements will be assessed if a replacement file is not received. (For penalty information, refer to the Penalty section of the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G.*)

Note: Tape Cartridges must be received at IRS/ECC-MTB by December 1, 2008. After December 1, 2008 only electronic files will be accepted.

Sec. 10. Corrected Returns

- A **correction** is an information return submitted by the transmitter to correct an information return that was previously submitted to and successfully processed by IRS/ECC-MTB, but contained erroneous information.

- While we encourage you to file your corrections electronically/magnetically, you may file up to 249 paper corrections even though your originals were filed electronically or magnetically.

- **DO NOT SEND YOUR ENTIRE FILE AGAIN**. Only correct the information returns which were erroneous.

- Information returns omitted from the original file **must not** be coded as corrections. Submit these returns under a separate Payer "A" Record as original returns.

- Be sure to use the same payee account number that was used on the original submission. The account number is used to match a correction record to the original information return.

- Before creating your correction file, review the correction guidelines chart carefully.

.01 The magnetic media filing requirement of information returns of 250 or more applies separately to both original and corrected returns.

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If a payer has 100 Forms 1099–A to be corrected, they can be filed on paper because they fall under the 250 threshold. However, if the payer has 300 Forms 1099–B to be corrected, they must be filed electronically or magnetically because they meet the 250 threshold. If for some reason a payer cannot file the 300 corrections electronically or magnetically, to avoid penalties, a request for a waiver must be submitted before filing on paper. If a waiver is approved for original documents, any corrections for the same type of return will be covered under this waiver.

.02 Corrections should be filed **as soon as possible**. Corrections filed after August 1 may be subject to the maximum penalty of $50 per return. Corrections filed by August 1 may be subject to a lesser penalty. (For information on penalties, refer to the Penalties section of the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G.*) However, if payers discover errors after August 1, they should file corrections, as prompt correction is a factor considered in determining whether the intentional disregard penalty should be assessed or whether a waiver of the penalty for reasonable cause may be granted. All fields must be completed with the correct information, not just the data fields needing correction. Submit corrections only for the returns filed in error, not the entire file. Furnish corrected statements to recipients as soon as possible.

Note: Do NOT resubmit your entire file as corrections. This will result in duplicate filing and erroneous notices may be sent to payees. Submit only those returns which require correction.

.03 There are numerous types of errors, and in some cases, more than one transaction may be required to correct the initial error. If the original return was filed as an aggregate, the filers must consider this in filing corrected returns.

.04 The payee's account number should be included on **all** correction records. This is especially important when more than one information return of the same type is reported for a payee. The account number is used to determine which information return is being corrected. It is vital that each information return reported for a payee have a unique account number. See Part D, Sec. 6, Payer's Account Number For Payee.

.05 Corrected returns may be included on the same media as original returns; however, separate "A" Records are required. Corrected returns must be identified on Form 4804 and the external media label by indicating "Correction." If filers discover that certain information returns were omitted on their original file, they must not code these documents as corrections. The file must be coded and submitted as originals.

.06 If a payer realizes duplicate reporting has occurred, IRS/ECC-MTB should be contacted **immediately** for instructions on how to avoid notices. The standard correction process will not resolve duplicate reporting.

.07 If a payer discovers errors that affect a large number of payees, in addition to sending IRS the corrected returns and notifying the payees, IRS/ECC-MTB underreporter section should be contacted toll-free 1–866–455–7438 for additional requirements. Corrections must be submitted on actual information return documents or filed electronically/magnetically. Form 4804 must be submitted with corrected files submitted magnetically. If filing magnetically, provide the correct tax year in Block 2 of Form 4804 and on the external media label. A separate Form 4804 must be submitted for each tax year reported magnetically. Form 4804 is not required for electronic filing.

.08 Prior year data, original and corrected, **must** be filed according to the requirements of this Revenue Procedure. When submitting prior year data, use the record format for the current year. Each tax year must be submitted on separate media. However, use the actual year designation of the data in Field Positions 2–5 of the "T", "A", and "B" Records. Field position 6, Prior Year Data Indicator, in the Transmitter 'T' Record must contain a 'P'. If filing electronically, a separate transmission must be made for each tax year.

.09 In general, filers should submit corrections for returns filed within the last 3 calendar years (4 years if the payment is a reportable payment subject to backup withholding under section 3406 of the Code and also for Form 1099–C, Cancellation of Debt).

.10 All paper returns, whether original or corrected, must be filed with the appropriate service center. **IRS/ECC-MTB does not process paper returns.**

.11 If a payer discovers an error(s) in reporting the **payer** name and/or TIN, write a letter to IRS/ECC-MTB (See Part A, Sec. 3) containing the following information:

(a) Name and address of payer
(b) Type of error (please include the incorrect payer name/TIN that was reported)
(c) Tax year
(d) Payer TIN
(e) TCC
(f) Type of return
(g) Number of payees
(h) Filing method, paper, electronic, or tape cartridge

.12 The "B" Record provides a 20-position field for a unique Payer's Account Number for Payee. If a payee has more than one reporting of the same document type, it is vital that each reporting is assigned a unique account number. This number will help

identify the appropriate incorrect return if more than one return is filed for a particular payee. **Do not enter a TIN in this field.** A payer's account number for the payee may be a checking account number, savings account number, serial number, or any other number assigned to the payee by the payer that will distinguish the specific account. This number should appear on the initial return and on the corrected return in order to identify and process the correction properly.

.13 The record sequence for filing corrections is the same as for original returns.

.14 Review the chart that follows. Errors normally fall under one of the two categories listed. Next to each type of error is a list of instructions on how to file the corrected return.

Guidelines for Filing Corrected Returns Electronically/Magnetically

Note: References to Form 4804 apply to magnetically filed returns only. Form 4804 is not required for files submitted electronically through the FIRE System.

One transaction is required to make the following corrections properly. (See Note 3.)

Error Made on the Original Return	How To File the Corrected Return
ERROR TYPE 1	**CORRECTION**
1. Original return was filed with one or more of the following errors: **(a)** Incorrect payment amount codes in the Payer "A" Record **(b)** Incorrect payment amounts in the Payee "B" Record **(c)** Incorrect code in the distribution code field in Payee "B" Record **(d)** Incorrect payee address **(See Note 3.)** **(e)** Incorrect payee indicator **(See Note 1.)** **(f)** Incorrect payee name **(See Notes 2 & 3.)** **Note 1: Payee indicators are non-money amount indicator fields located in the specific form record layouts of the Payee "B" Record between field positions 544–748.** **Note 2: For information on errors to the payer's name and TIN (See Part A, Sec. 10, .11).** **Note 3: To correct a TIN and/or payee name and address follow the instructions under Error Type 2.**	**A.** Prepare a new Form 4804 that includes information relating to this new file. **B.** Mark "Correction" in Block 1 of Form 4804. **C.** Prepare a new file. The first record on the file will be the Transmitter "T" Record. **D.** Make a separate "A" Record for each type of return and each payer being reported. Payer information in the "A" Record must be the same as it was in the original submission. **E.** The Payee "B" Records must show the correct record information as well as a Corrected Return Indicator Code of "G" in Field Position 6. **F.** Corrected returns using "G" coded "B" Records may be on the same file as those returns submitted without the "G" coded "B" Records; however, **separate "A" Records are required.** **G.** Prepare a separate "C" Record for each type of return and each payer being reported. **H.** The last record on the file will be the End of Transmission "F" Record. **I.** Indicate "Correction" on the external media label.

File layout **one** step corrections

Transmitter "T" Record	Payer "A" Record	"G" coded Payee "B" Record	"G" coded Payee "B" Record	End of Payer "C" Record	End of Transmission "F" Record

Guidelines for Filing Corrected Returns Electronically/Magnetically (Continued)

Two (2) separate transactions are required to make the following corrections properly. Follow the directions for both Transactions 1 and 2. (See Note 5.) DO NOT use the two step correction process to correct money amounts.

Error Made on the Original Return	How To File the Corrected Return
ERROR TYPE 2	**CORRECTION**
1. Original return was filed with one or more of the following errors: **(a)** No payee TIN (SSN, EIN, ITIN, QI-EIN) **(b)** Incorrect payee TIN **(c)** Incorrect payee name and address **(d)** Wrong type of return indicator **Note 4: The Record Sequence Number will be different since this is a counter number and is unique to each file. For 1099–R corrections, if the corrected amounts are zeros, certain indicators will not be used.**	**Transaction 1:** Identify incorrect returns. **A.** Prepare a new Form 4804 that includes information related to this new file. **B.** Mark "Correction" in Block 1 of Form 4804. **C.** Prepare a new file. The first record on the file will be the Transmitter "T" Record. **D.** Make a separate "A" Record for each type of return and each payer being reported. The information in the "A" Record will be **exactly** the same as it was in the original submission. **(See Note 4.)** **E.** The Payee "B" Records must contain **exactly the same** information as submitted previously, **except**, insert a Corrected Return Indicator Code of "G" in Field Position 6 of the "B" Records, and enter "0" (zeros) in all payment amounts. **(See Note 4.)** **F.** Corrected returns using "G" coded "B" Records may be on the same file as those returns submitted with a "C" code; **however, separate "A" Records are required.** **G.** Prepare a separate "C" Record for each type of return and each payer being reported. **H.** Continue with Transaction 2 to complete the correction. **Transaction 2:** Report the correct information. **A.** Make a separate "A" Record for each type of return and each payer being reported. **B.** The Payee "B" Records must show the correct information as well as a Corrected Return Indicator Code of "C" in Field Position 6. **C.** Corrected returns submitted to IRS/ECC-MTB using "C" coded "B" Records may be on the same file as those returns submitted with "G" codes; **however, separate "A" Records are required.**

Guidelines for Filing Corrected Returns Electronically/Magnetically (Continued)	
Two (2) separate transactions are required to make the following corrections properly. Follow the directions for both Transactions 1 and 2. (See Note 5.) DO NOT use the two step correction process to correct money amounts.	
Error Made on the Original Return	How To File the Corrected Return
<u>ERROR TYPE 2</u>	<u>CORRECTION</u> **Transaction 2:** Report the correct information. **D.** Prepare a separate "C" Record for each type of return and each payer being reported. **E.** The last record on the file will be the End of Transmission "F" Record. **F.** Indicate "Correction" on the external media label.
Note 5: See the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G* for additional information on regulations affecting corrections and related penalties.	

File layout **two** step corrections

Transmitter "T" Record	Payer "A" Record	"G" coded Payee "B" Record	"G" coded Payee "B" Record	End of Payer "C" Record	Payer "A" Record

"C" coded Payee "B" Record	"C" coded Payee "B" Record	End of Payer "C" Record	End of Transmission "F" Record

Note 6: If a filer is reporting "G" coded, "C" coded, and/or "Non-coded" (original) returns on the same file, each category must be reported under separate "A" Records.

Sec. 11. Effect on Paper Returns and Statements to Recipients

.01 Electronic/Magnetic reporting of information returns eliminates the need to submit paper documents to the IRS. **CAUTION: Do not send Copy A of the paper forms to IRS/ECC-MTB for any forms filed electronically or magnetically.** This will result in duplicate filing; therefore, erroneous notices could be generated.

.02 Payers are responsible for providing statements to the payees as outlined in the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G*. Refer to those instructions for filing information returns on paper with the IRS and furnishing statements to recipients.

.03 Statements to recipients should be clear and legible. If the official IRS form is not used, the filer must adhere to the specifications and guidelines in Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W–2G and 1042–S.

Sec. 12. Combined Federal/State Filing Program

- Through the Combined Federal/State Filing (CF/SF) Program, IRS/ECC-MTB will forward original and corrected information returns filed electronically or magnetically to participating states for approved filers.

- For approval, the filer must submit a test file coded for this program. See Part B, Sec. 4, Test Files.

- For tape cartridge test files, attach a letter to Form 4804 requesting approval to participate in the CF/SF Program. Form 4804 or letter is not required for tests sent electronically.

- Approved filers are sent Form 6847, Consent for Internal Revenue Service to Release Tax Information, which must be completed and returned to IRS/ECC-MTB. A separate form is required for each payer.

.01 The Combined Federal/State Filing (CF/SF) Program was established to simplify information returns filing for the taxpayer. IRS/ECC-MTB will forward this information to participating states free of charge for approved filers. Separate reporting to those states is not required. The following information returns may be filed under the Combined Federal/State Filing Program:

Form 1099–DIV	Dividends and Distributions
Form 1099–G	Certain Government Payments
Form 1099–INT	Interest Income
Form 1099–MISC	Miscellaneous Income
Form 1099–OID	Original Issue Discount
Form 1099–PATR	Taxable Distributions Received From Cooperatives
Form 1099–R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
Form 5498	IRA Contribution Information

.02 To request approval to participate, a tape cartridge test file coded for this program **must** be submitted to IRS/ECC-MTB between *November l, 2007, and December 15, 2007. Media must be* ***postmarked*** *no later than December 1, 2007 in order to be received at ECC-MTB by December 15 for processing*. Electronic test files coded for this program must be submitted between *November 1, 2007*, and *February 15, 2008.*

.03 Attach a letter to Form 4804 submitted with the test file to indicate the filer is requesting approval to participate in the Combined Federal/State Filing Program. Test files sent electronically do not require Form 4804 or letter. If the test file is coded for the Combined Federal/State Filing Program and is acceptable, an approval letter and Form 6847, Consent for Internal Revenue Service to Release Tax Information, will be sent to the filer.

.04 Form 6847, Consent for Internal Revenue Service to Release Tax Information, **must** be completed and signed by the payer, and returned to IRS/ECC-MTB before any tax information can be released to the state. Filers must write their TCC on Form 6847.

.05 While a test file is only required for the first year when a filer applies to participate in the Program, it is highly recommended that a test be sent every year you participate in the Combined Federal/State Filing program. Each record, both in the test and the actual data file, must conform to the current Revenue Procedure.

.06 If the test file is not acceptable, IRS/ECC-MTB will send tape cartridge filers information indicating the problems. Electronic filers must log on to the FIRE System within two business days to check the acceptability of their test file. The new test file must be postmarked no later than December 1, 2007 for tape cartridges, or transmitted by February 15, 2008 for an electronically filed test.

.07 A separate Form 6847 is **required** for each payer. A transmitter may not combine payers on one Form 6847 even if acting as Attorney-in-Fact for several payers. Form 6847 may be computer-generated as long as it includes all information on the original form, or it may be photocopied. If Form 6847 is signed by an Attorney-in-Fact, the written consent from the payer must clearly indicate that the Attorney-in-Fact is empowered to authorize release of the information.

.08 Only code the records for participating states and for those payers who have submitted Form 6847.

.09 If a payee has a reporting requirement for more than one state, separate "B" records must be created for each state. Payers must pro-rate the amounts to determine what should be reported to each state. Do **not** report the total amount to each state. This will cause duplicate reporting.

.10 Some participating states require separate notification that the payer is filing in this manner. Since IRS/ECC-MTB acts as a forwarding agent only, it is the payer's responsibility to contact the appropriate states for further information.

.11 All corrections properly coded for the Combined Federal/State Filing Program will be forwarded to the participating states. Only send corrections which affect the Federal reporting. Errors which apply only to the state filing requirement should be sent directly to the state.

.12 Participating states and corresponding valid state codes are listed in **Table 1** of this section. The appropriate state code **must** be entered for those documents that meet the state filing requirements; **do not use state abbreviations.**

.13 Each state's filing requirements are subject to change by the state. It is the payer's responsibility to contact the participating states to verify their criteria.

.14 Upon submission of the actual files, the transmitter **must** be sure of the following:

(a) All records are coded exactly as required by this Revenue Procedure.

(b) A State Total "K" Record(s) for each state(s) being reported follows the "C" Record.

(c) Payment amount totals and the valid participating state code are included in the State Totals "K" Record(s).

(d) The last "K" Record is followed by an "A" Record or an End of Transmission "F" Record (if this is the last record of the entire file).

Table 1. Participating States and Their Codes *

State	Code	State	Code	State	Code
Alabama	01	Indiana	18	Nebraska	31
Arizona	04	Iowa	19	New Jersey	34
Arkansas	05	Kansas	20	New Mexico	35
California	06	Louisiana	22	North Carolina	37
Colorado	07	Maine	23	North Dakota	38
Connecticut	08	Maryland	24	Ohio	39
Delaware	10	Massachusetts	25	South Carolina	45
District of Columbia	11	Minnesota	27	Utah	49
Georgia	13	Mississippi	28	Virginia	51
Hawaii	15	Missouri	29	Wisconsin	55
Idaho	16	Montana	30		

*** The codes listed above are correct for the IRS Combined Federal/State Filing Program and may not correspond to the state codes of other agencies or programs.**

Sample File Layout for Combined Federal/State Filer

Transmitter "T" Record	Payer "A" Record coded with 1 in position 26	Payee "B" Record with state code 15 in position 747–748	Payee "B" Record with state code 06 in position 747–748	Payee "B" Record, no state code	End of Payer "C" Record

State Total "K" Record for "B" records coded 15. "K" record coded 15 in positions 747–748.	State Total "K" Record for "B" records coded 06. "K" record coded 06 in positions 747–748.	End of Transmission "F" Record

Sec. 13. Penalties Associated With Information Returns

.01 The following penalties generally apply to the person required to file information returns. The penalties apply to electronic/magnetic media filers as well as to paper filers.

.02 Failure To File Correct Information Returns by the Due Date (Section 6721). If you fail to file a correct information return by the due date and you cannot show reasonable cause, you may be subject to a penalty. The penalty applies if you fail to file timely, you fail to include all information required to be shown on a return, or you include incorrect information on a return. The penalty also applies if you file on paper when you were required to file either electronically or magnetically, you report an incorrect TIN or fail to report a TIN, or you fail to file paper forms that are machine readable.

The amount of the penalty is based on when you file the correct information return. The penalty is:

- **$15** per information return if you correctly file within 30 days of the due date of the return (See Part A, Sec. 8, .01); maximum penalty $75,000 per year ($25,000 for small businesses).
- **$30** per information return if you correctly file more than 30 days after the due date but by August 1; maximum penalty $150,000 per year ($50,000 for small businesses).
- **$50** per information return if you file after August 1 or you do not file required information returns; maximum penalty $250,000 per year ($100,000 for small businesses).

.03 A late filing penalty may be assessed for a replacement file which is not returned by the required date. Depending on your method of reporting, replacement files may be subject to penalty. See Part A, Sec. 9, or Part B, Sec. 5, .06 for more information on replacement files.

.04 Intentional disregard of filing requirements. If failure to file a correct information return is due to intentional disregard of the filing or correct information requirements, the penalty is at least $100 per information return with no maximum penalty.

.05 Failure To Furnish Correct Payee Statements (Section 6722). For information regarding penalties which may apply to failure to furnish correct payee statements, see *2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.*

Sec. 14. State Abbreviations

.01 The following state and U.S. territory abbreviations are to be used when developing the state code portion of address fields. This table provides state and territory abbreviations only, and does not represent those states participating in the Combined Federal/State Filing Program.

State	Code	State	Code	State	Code
Alabama	AL	Kentucky	KY	No. Mariana Islands	MP
Alaska	AK	Louisiana	LA	Ohio	OH
American Samoa	AS	Maine	ME	Oklahoma	OK
Arizona	AZ	Marshall Islands	MH	Oregon	OR
Arkansas	AR	Maryland	MD	Pennsylvania	PA
California	CA	Massachusetts	MA	Puerto Rico	PR
Colorado	CO	Michigan	MI	Rhode Island	RI
Connecticut	CT	Minnesota	MN	South Carolina	SC
Delaware	DE	Mississippi	MS	South Dakota	SD
District of Columbia	DC	Missouri	MO	Tennessee	TN
Federated States of Micronesia	FM	Montana	MT	Texas	TX
Florida	FL	Nebraska	NE	Utah	UT
Georgia	GA	Nevada	NV	Vermont	VT
Guam	GU	New Hampshire	NH	Virginia	VA
Hawaii	HI	New Jersey	NJ	(U.S.) Virgin Islands	VI
Idaho	ID	New Mexico	NM	Washington	WA
Illinois	IL	New York	NY	West Virginia	WV
Indiana	IN	North Carolina	NC	Wisconsin	WI
Iowa	IA	North Dakota	ND	Wyoming	WY
Kansas	KS				

.02 Filers must adhere to the city, state, and ZIP Code format for U.S. addresses in the "B" Record. This also includes American Samoa, Federated States of Micronesia, Guam, Marshall Islands, Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands.

.03 For foreign country addresses, filers may use a 51 position free format which should include city, province or state, postal code, and name of country in this order. This is allowable only if a "1" (one) appears in the Foreign Country Indicator, Field Position 247, of the "B" Record.

.04 When reporting APO/FPO addresses, use the following format:

EXAMPLE:

Payee Name	PVT Willard J. Doe
Mailing Address	Company F, PSC Box 100
	167 Infantry REGT
Payee City	APO (or FPO)
Payee State	AE, AA, or AP*
Payee ZIP Code	098010100

*AE is the designation for ZIPs beginning with 090–098, AA for ZIP 340, and AP for ZIPs 962–966.

Sec. 15. Major Problems Encountered

IRS/ECC-MTB encourages filers to verify the format and content of each type of record to ensure the accuracy of the data. This may eliminate the need for IRS/ECC-MTB to request replacement files. This may be important for those payers who have either had their files prepared by a service bureau or who have purchased software packages.

Filers who engage a service bureau to prepare media on their behalf should be careful not to report duplicate data, which may generate penalty notices.

The Major Problems Encountered lists some of the problems most frequently encountered with electronic/magnetic files submitted to IRS/ECC-MTB. These problems may result in IRS/ECC-MTB requesting replacement files.

1. Unable to read tape cartridge.

Please review all tape cartridge specifications carefully (See Part C, Sections 1 and 2.)

2. No Form 4804, Transmittal of Information Returns Reported Magnetically

Each shipment of media sent to IRS/ECC-MTB must include a **signed** Form 4804.

3. Discrepancy Between IRS/ECC-MTB Totals and Totals in Payer "C" Records

The "C" Record is a summary record for a type of return for a given payer. IRS compares the total number of payees and payment amounts in the "B" records with totals in the "C" Records. The two totals **must** agree. Do **NOT** enter negative amounts except when reporting Forms 1099–B or 1099–Q. Money amounts must be all numeric, right-justified and zero (0) fill unused positions. **Do Not Use Blanks.**

4. The Payment Amount Fields in the "B" Record Do Not Correspond to the Amount Codes in the "A" Record.

The Amount Codes used in the "A" record MUST correspond with the payment amount fields used in the "B" records. The amount codes must be left-justified, in ascending order with the unused positions blank. For Example: If the "B" records show payment amounts in payment amount fields 2, 4, and 7, then the "A" record must correspond with 2, 4, and 7 in the amount codes field.

5. Incorrect TIN in Payer "A" Record.

The Payer's TIN reported in positions 12–20 of the "A" record must be nine numeric characters only. **(Do Not Enter Hyphen.)** The TIN and the First Payer Name Line provided in the "A" record must correspond.

6. Incorrect Tax Year in the Transmitter "T" Record, Payer "A" Record and the Payee "B" Records.

The tax year in the transmitter, payer and payee records should reflect the tax year of the information return being reported. For prior tax year data, there must be a "P" in position 6 of the Transmitter "T" record. Media postmarked December 2, 2007 or later **must** have the Prior Year Data Indicator coded with a "P" in position 6 of the Transmitter "T" Record. This position must be blank for current tax year data.

7. Incorrect use of Test Indicator.

When sending a test file, position 28 of the Transmitter "T" record must contain a "T", otherwise blank fill.

8. Incorrect Format for TINs in the Payee "B" Record.

TINs entered in position 12–20 of the Payee "B" record must consist of nine numerics only. **(Do Not Enter Hyphens.)** Incorrect formatting of TINs may result in a penalty.

9. Distribution Codes for Form 1099–R Reported Incorrectly.

For Forms 1099–R, there must be valid Distribution Code(s) in position 545–546 of the Payee "B" record. For valid codes (and combinations), see Guide to Distribution Codes in Part D. If only one distribution code is required, it must be entered in position 545 and position 546 must be blank. A blank in position 545 is not acceptable.

10. Incorrect Record Totals Listed on Form 4804.

The Combined Total Payee Records listed on Form 4804 (Block 6) are used in the verification process of information returns. The figure in this block **must** be the total number of payee "B" records contained on each individual piece of media submitted. A separate Form 4804 should be sent for each piece of media that contains a file.

11. Missing Correction Indicator in Payee "B" Record.

When a file is submitted as a correction file, there must be a correction indicator, "G" or "C" in position 6 of the Payee "B" record. See Part A, Sec. 10.

Part B. Electronic Filing Specifications

Note: ***The FIRE System DOES NOT provide fill-in forms, except for Form 8809, Application for Extension of Time To File Information Returns.*** **Filers must program files according to the Record Layout Specifications contained in this publication. For a list of software providers, log on to www.irs.gov and go to the Approved IRS e-file for Business Providers link.**

Sec. 1. General

.01 Electronic filing of Forms 1098, 1099, 5498, and W–2G information returns, originals, corrections, and replacements is offered as an alternative to tape cartridges or paper filing. Filing electronically will fulfill the magnetic media requirements for those payers who are required to file magnetically. Payers who are under the filing threshold requirement, are encouraged to file electronically. If the original file was sent magnetically, but IRS/ECC-MTB has requested a replacement file, the replacement may be transmitted electronically. Also, if the original file was submitted via tape cartridge, any corrections may be transmitted electronically.

.02 All electronic filing of information returns are received at IRS/ECC-MTB via the FIRE (Filing Information Returns Electronically) System. To connect to the FIRE System, point your browser to http://fire.irs.gov. The system is designed to support the electronic filing of information returns only.

.03 The electronic filing of information returns is not affiliated with any other IRS electronic filing programs. Filers must obtain separate approval to participate in each program. Only inquiries concerning electronic filing of information returns should be directed to IRS/ECC-MTB.

.04 Files submitted to IRS/ECC-MTB electronically must be in standard ASCII code. Do not send tape cartridges or paper forms with the same information as electronically submitted files. This would create duplicate reporting resulting in penalty notices.

.05 The record formats of the "T", "A", "B", "C", "K", and "F" records are the same for both electronically or magnetically filed records. See Part D, Record Format Specifications and Record Layouts.

Sec. 2. Advantages of Filing Electronically

Some of the advantages of filing electronically are:

(1) Paperless, no Form 4804 requirements.
(2) Security — Secure Socket Layer (SSL) 128-bit encryption.
(3) The File Status results will be emailed to you in 1–2 business days if the correct email address is provided. It is the filer's responsibility to log into the system and check results if the file is bad or you disagree with the count of payees.
(4) Later due date than tape cartridge or paper for electronically filed Forms 1098, 1099, and W–2G (refer to Part A, Sec. 8, .01).
(5) Allows more attempts than a tape cartridge filing to replace bad files within a specific time frame before imposing penalties (refer to Part B, Sec. 5, .06).
(6) Better customer service due to on-line availability of transmitter's files for research purposes.
(7) Extended period to test electronic files: November 1, 2007 to February 15, 2008.

Sec. 3. Electronic Filing Approval Procedure

.01 Filers must obtain a Transmitter Control Code (TCC) prior to submitting files electronically. Filers who currently have a TCC for magnetic media filing may use their assigned TCC for electronic filing. Refer to Part A, Sec. 6, for information on how to obtain a TCC.

.02 Once a TCC is obtained, electronic filers assign their own user ID, password and PIN (Personal Identification Number) and do not need prior or special approval. See Part B, Sec. 6, for more information on the PIN.

.03 If a filer is submitting files for more than one TCC, it is not necessary to create a separate logon and password for each TCC.

.04 For all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and must be 8 alpha/numerics containing at least 1 uppercase, 1 lowercase, and 1 numeric. However, filers who forget their password or PIN, can call **toll-free 1–866–455–7438 extension 3** for assistance. The FIRE System may require users to change their passwords on a yearly basis.

Sec. 4. Test Files

.01 Filers are not required to submit a test file; however, the submission of a test file is encouraged for all new electronic filers to test hardware and software. If filers wish to submit an electronic test file for Tax Year *2007* (returns to be filed in *2008*), it **must** be submitted to IRS/ECC-MTB **no earlier than** November 1, 2007, and **no later than** February 15, 2008.

.02 Filers who encounter problems while transmitting the electronic test file can contact IRS/ECC-MTB **toll-free 1–866–455–7438 extension 3** for assistance.

.03 Within 1–2 days after your file has been sent, you will be notified via email as to the acceptability of your file if you provide a valid email address on the 'Verify Your Filing Information' screen. If the file is bad, the filer must return to http://fire.irs.gov to determine what the errors are in the file by clicking on CHECK FILE STATUS. If your results indicate:

(a) **"Good, Federal Reporting"** — Your test file is good for federal reporting only. Click on the filename for additional details.

(b) **"Good, Federal/State Reporting"** — Your file is good for the Combined Federal and State Filing Program (see Part A, Section 12 for further details). Click on the filename for additional details.

(c) **"Bad"** — This means that your test file contained errors. Click on the filename for a list of the errors. If you want to send another test file, send it as another test (not a replacement, original or correction).

(d) **"Not Yet Processed"** — The file has been received, but we do not have results available yet. Please allow another day for results.

.04 Form 4804 is not required for test files submitted electronically. See Part B, Sec. 4.

.05 A test file is required from filers who want approval for the Combined Federal/State Filing Program. See Part A, Sec. 12, for further details.

Sec. 5. Electronic Submissions

.01 Electronically filed information may be submitted to IRS/ECC-MTB 24 hours a day, 7 days a week. Technical assistance is available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time by calling **toll-free 1–866–455–7438 extension 3.**

.02 The FIRE System will be down from 2 p.m. EST December 20, 2007, through January 2, 2008. This allows IRS/ECC-MTB to update its system to reflect current year changes.

.03 If you are sending files larger than 10,000 records electronically, data compression is encouraged. When transmitting files larger than 5 million records, please contact IRS/ECC-MTB for additional information. WinZip and PKZIP are the only acceptable compression packages. IRS/ECC-MTB cannot accept self-extracting zip files or compressed files containing multiple files. The time required to transmit information returns electronically will vary depending upon the type of connection to the internet and if data compression is used. **The time required to transmit a file can be reduced up to 95 percent by using compression.**

.04 The FIRE System can accept multiple files for the same type of return providing duplicate data is not transmitted. For example, if your company has several branches issuing 1099–INT forms; it is not necessary to consolidate all the forms into one transmission. Each file may be sent separately, **providing duplicate data is not transmitted.**

.05 Transmitters may create files using self assigned filename(s). Files submitted electronically will be assigned a new unique file name by the FIRE System. The filename assigned by the FIRE System will consist of submission type (TEST, ORIG [original], CORR [correction], and REPL [replacement]), the filer's TCC and a four-digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 44444, the IRS assigned filename would be ORIG.44444.0001. **Record the filename.** This information will be needed by ECC-MTB to identify the file, if assistance is required.

.06 If a file was submitted timely and is bad, the filer will have up to 60 days from the day the file was transmitted to transmit an acceptable file. If an acceptable file is not received within 60 days, the payer could be subject to late filing penalties. This only applies to files originally submitted electronically.

.07 The following definitions have been provided to help distinguish between a correction and a replacement:

- A **correction** is an information return submitted by the transmitter to correct an information return that was previously submitted to and processed by IRS/ECC-MTB, but contained erroneous information. **(See Note.)**

Note: Corrections should only be made to records that have been submitted incorrectly, not the entire file.

- A **replacement** is an information return file sent by the filer because the CHECK FILE STATUS option on the FIRE System indicated the original/correction file was bad. After the necessary changes have been made, the file must be transmitted through the FIRE System. **(See Note.)**

Note: Filers should never transmit anything to IRS/ECC-MTB as a "Replacement" file unless the CHECK FILE STATUS option on the FIRE System indicates the file is bad.

.08 The TCC in the Transmitter "T" Record must be the TCC used to transmit the file; otherwise, the file will be considered an error.

Sec. 6. PIN Requirements

.01 Form 4804 is not required for electronic files. Instead, the user will be prompted to create a PIN consisting of 10 numerics when establishing their initial logon name and password.

.02 The PIN is required each time an ORIGINAL, CORRECTION, or REPLACEMENT file is sent electronically and is permission to release the file. It is not needed for a TEST file. An authorized agent may enter their PIN, however, the payer is responsible for the accuracy of the returns. The payer will be liable for penalties for failure to comply with filing requirements. If you forget your PIN, please call **toll-free 1–866–455–7438 extension 3** for assistance.

.03 If the file is good, it is released for mainline processing after 10 calendar days from receipt. Contact us **toll-free 1–866–455–7438 extension 3** within this 10-day period if there is a reason the file should not be released for further processing. If the file is bad, follow normal replacement procedures.

Sec. 7. Electronic Filing Specifications

.01 The FIRE System is designed exclusively for the filing of Forms 1042–S, 1098, 1099, 5498, 8027, and W–2G.

.02 A transmitter must have a TCC (see Part A, Sec. 6) before a file can be transmitted. A TCC assigned for magnetic media filing should also be used for electronic filing.

.03 After 1–2 business days, the results of the electronic transmission will be emailed to you providing you provide an accurate email address on the 'Verify Your Filing Information' screen. If you are using email filtering software, configure your software to accept emails from fire@irs.gov. If after receiving the email it indicates that your file is bad, you must log into the FIRE System and go to the CHECK FILE STATUS area of the FIRE System to determine what the errors are in your file. Forms 1042–S and 8027 require a longer processing time and emails are not sent for these forms.

Sec. 8. Connecting to the FIRE System

.01 Point your browser to http://fire.irs.gov to connect to the FIRE System.

.02 Filers should turn off their pop-up blocking software before transmitting their files.

.03 Before connecting, have your TCC and EIN available.

.04 Your browser must support SSL 128-bit encryption.

.05 Your browser must be set to receive "cookies". Cookies are used to preserve your User ID status.

First time connection to The FIRE System (If you have logged on previously, skip to Subsequent Connections to the FIRE System.)

Click ***"Create New Account".***
Fill out the registration form and click ***"Submit"***.
Enter your ***User ID*** (most users logon with their first and last name).
Enter and verify your ***password*** (the password is user assigned and must be 8 alpha/numerics, containing at least 1 uppercase, 1 lowercase and 1 numeric). FIRE may require you to change the password once a year.
Click ***"Create".***
If you receive the message **"Account Created"**, click ***"OK".***
Enter and verify your 10-digit self-assigned PIN (Personal Identification Number).
Click ***"Submit".***
If you receive the message **"Your PIN has been successfully created!",** click ***"OK".***
Read the bulletin(s) and/or **"Click here to continue"**.

Subsequent connections to The FIRE System

Click ***"Log On".***
Enter your ***User ID*** (most users logon with their first and last name).
Enter your ***password*** (the password is user assigned and is case sensitive).
Read the bulletin(s) and/or "**Click here to continue**".

Uploading your file to the FIRE System

At Menu Options:

Click *"Send Information Returns"*
Enter your *TCC:*
Enter your *EIN:*
Click *"Submit".*

The system will then display the company name, address, city, state, ZIP Code, phone number, contact and email address. This information will be used to email the transmitter regarding their transmission. Update as appropriate and/or Click *"Accept"*.

Note: Please ensure that the email is accurate so that the correct person receives the email and it does not return to us undeliverable. If you are using SPAM filtering software, please configure it to allow an email from fire@irs.gov.

Click one of the following:

Original File
Correction File
Test File *(This option will only be available from 11/1/2007 - 02/15/2008.)*
Replacement File (if you select this option, select one of the following):

Electronic Replacement (file was originally transmitted on this system)
Click on the file to be replaced.

Magnetic Media Replacement
Enter the alpha character from Form 9267, Media Tracking Slip, that was sent with the request for replacement file. Click *"Submit"*.

Enter your 10-digit PIN (not prompted for this if a test is being sent).
Click *"Submit".*
Click *"Browse"* to locate the file and open it.
Click *"Upload".*

When the upload is complete, the screen will display the total bytes received and tell you the name of the file you just uploaded.

If you have more files to upload for that TCC:

Click *"File Another?";* otherwise,
Click *"Main Menu".*

It is your responsibility to check the acceptability of your file; therefore, be sure to check back into the system in 1–2 business days using the CHECK FILE STATUS option.

Checking your FILE STATUS

If the correct email address was provided on the "Verify Your Filing Information" screen when the file was sent, an email will be sent regarding your FILE STATUS. If the results in the email indicate "Good, not Released" and you agree with the "Count of Payees", then you are finished with this file. If you have any other results, please follow the instructions below.

At the Main Menu:

Click *"Check File Status".*
Enter your *TCC:*
Enter your *EIN:*
Click *"Search".*

If "Results" indicate:

"Good, Not Released" and you agree with the "Count of Payees", you are finished with this file. The file will automatically be released after 10 calendar days unless you contact us within this timeframe.

"Good, Released" – File has been released to our mainline processing.

"Bad" – Correct the errors and timely resubmit the file as a "replacement".

"Not yet processed" – File has been received, but we do not have results available yet. Please check back in a few days.

Click on the desired file for a detailed report of your transmission.
When you are finished, click on *Main Menu.*

Click *"Log Out".*
Close your Web Browser.

Sec. 9. Common Problems and Questions Associated with Electronic Filing

.01 Refer to Part A, Sec. 15, for common format errors associated with electronic/magnetic files.
.02 The following are the major errors associated with electronic filing:

NON-FORMAT ERRORS

1. Transmitter does not check the FIRE System to determine why the file is bad.

The results of your file transfer are posted to the FIRE System within two business days. If the correct email address was provided on the "Verify Your Filing Information" screen when the file was sent, an email will be sent regarding your FILE STATUS. If the results in the email indicate "Good, not Released" and you agree with the "Count of Payees", then you are finished with this file. If you have any other results, please follow the instructions in the Check File Status option. If the file contains errors, you can get an online listing of the errors. Date received and number of payee records are also displayed. If the file is good, but you do not want the file processed, you must contact IRS/ECC-MTB within 10 calendar days from the transmission of your file.

2. Incorrect file is not replaced timely.

If your file is bad, correct the file and timely resubmit as a replacement.

3. Transmitter compresses several files into one.

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

4. Transmitter sends a file and CHECK FILE STATUS indicates that the file is good, but the transmitter wants to send a replacement or correction file to replace the original/correction/replacement file.

Once a file has been transmitted, you cannot send a replacement file unless CHECK FILE STATUS indicates the file is bad (1–2 business days after file was transmitted). If you do not want us to process the file, you must first contact us **toll-free 1–866–455–7438 extension 3** to see if this is a possibility.

5. Transmitter sends an original file that is good, and then sends a correction file for the entire file even though there are only a few changes.

The correction file, containing the proper coding, should only contain the records needing correction, not the entire file.

6. File is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII code.

7. Transmitter has one TCC number, but is filing for multiple companies, which EIN should be used when logging into the system to send the file?

When sending the file electronically, you will need to enter the EIN of the company assigned to the TCC. When you upload the file, it will contain the EIN's of the other companies for which you are filing. This is the information that will be passed forward.

8. Transmitter sent the wrong file, what should be done?

Call us as soon as possible toll-free at **1–866–455–7438 extension 3.** We may be able to stop the file before it has been processed. **Please do not send a replacement for a file that is marked as a good file.**

Part C. Tape Cartridge Specifications

.01 Transmitters should be consistent in the use of recording codes and density on files. If the tape cartridge does not meet these specifications, IRS/ECC-MTB will request a replacement file. Filers are encouraged to submit a test prior to submitting the actual file. Contact IRS/ECC-MTB **toll-free 1–866–455–7438 extension 5** for further information. Transmitters should also check media for viruses before submitting to IRS/ECC-MTB.

.02 In most instances, IRS/ECC-MTB can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, 3590, or 3590E.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges must be 1/2-inch tape contained in plastic cartridges that are approximately 4-inches by 5-inches by 1-inch in dimension.

(2) Magnetic tape must be chromium dioxide particle based 1/2-inch tape.

(3) Cartridges must be 18-track, 36-track, 128-track or 256-track parallel **(See Note.)**

(4) Cartridges will contain 37,871 CPI, 75,742 CPI, or 3590 CPI (characters per inch).

(5) Mode will be full function.

(6) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

(7) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

.03 The tape cartridge records defined in this Revenue Procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,250 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields, which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block, which may be shorter (see item (b) above). The block length must be evenly divisible by 750.

(d) Records may not span blocks.

.04 Tape cartridges may be labeled or unlabeled.

.05 Do **not** send encrypted data.

.06 For the purposes of this Revenue Procedure, the following must be used:

Tape Mark:

(a) Signifies the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

Note: Filers should indicate on the external media label whether the cartridge is 18-track, 36-track, 128-track or 256-track.

Part D. Record Format Specifications and Record Layouts

Sec. 1. General

.01 The specifications contained in this part of the Revenue Procedure define the required formation and contents of the records to be included in the electronic or tape cartridge files.

.02 A provision is made in the "B" Records for entries which are optional. If the field is not used, enter blanks to maintain a fixed record length of 750 positions. Each field description explains the intended use of specific field positions.

Sec. 2. Transmitter "T" Record — General Field Descriptions

.01 The Transmitter "T" Record identifies the entity transmitting the electronic/tape cartridge file and contains information which is critical if it is necessary for IRS/ECC-MTB to contact the filer.

.02 The Transmitter "T" Record is the first record on each file and is followed by a Payer "A" Record. A file format diagram is located at the end of Part D. A replacement file will be requested by IRS/ECC-MTB if the "T" Record is not present.

.03 For all fields marked **"Required"**, the transmitter must provide the information described under Description and Remarks. For those fields not marked **"Required"**, a transmitter must allow for the field but may be instructed to enter blanks or zeros in the indicated field positions and for the indicated length.

.04 All records must be a fixed length of 750 positions.

.05 All alpha characters entered in the "T" Record must be upper-case, except email addresses which may be case sensitive. **Do not** use punctuation in the name and address fields.

Record Name: Transmitter "T" Record			
Field Position	**Field Title**	**Length**	**Description and Remarks**
1	Record Type	1	**Required.** Enter "T".
2–5	Payment Year	4	**Required.** Enter "*2007*". If reporting prior year data, report the year which applies (2005, 2006, etc.) and set the Prior Year Data Indicator in field position 6.
6	Prior Year Data Indicator	1	**Required.** Enter "P" **only** if reporting prior year data; otherwise, enter blank. Do not enter a "P" if tax year is *2007*. **(See Note.)**
Note: Current year data MAILED December 2 or later or electronic files SENT December 21 or later must be coded with a "P". Current year processing ends in December and programs are converted for the next processing year.			
7–15	Transmitter's TIN	9	**Required.** Enter the transmitter's nine-digit Taxpayer Identification Number (TIN). May be an EIN or SSN.
16–20	Transmitter Control Code	5	**Required.** Enter the five-character alpha/numeric Transmitter Control Code (TCC) assigned by IRS/ECC-MTB. A TCC must be obtained to file data with this program.
21–27	Blank	7	Enter blanks.
28	Test File Indicator	1	**Required for test files only**. Enter a "T" if this is a test file; otherwise, enter a blank.
29	Foreign Entity Indicator	1	Enter a "1" (one) if the transmitter is a foreign entity. If the transmitter is not a foreign entity, enter a blank.
30–69	Transmitter Name	40	**Required.** Enter the name of the transmitter in the manner in which it is used in normal business. Left-justify and fill unused positions with blanks.
70–109	Transmitter Name (Continuation)	40	**Required.** Enter any additional information that may be part of the name. Left-justify information and fill unused positions with blanks.
110–149	Company Name	40	**Required.** Enter the name of the company to be associated with the address where correspondence should be sent.
150–189	Company Name (Continuation)	40	Enter any additional information that may be part of the name of the company where correspondence should be sent.
190–229	Company Mailing Address	40	**Required.** Enter the mailing address where correspondence should be sent.
Note: Any correspondence relating to problem media or electronic files will be sent to this address. This should be the same address as in box 5 of Form 4804.			
For U.S. addresses, the payer city, state, and ZIP Code must be reported as a 40, 2, and 9-position field, respectively. **Filers must adhere to the correct format for the payer city, state, and ZIP Code. For foreign addresses,** filers may use the payer city, state, and ZIP Code as a continuous 51-position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Entity Indicator in position 29 must contain a "1" (one).			

Record Name: Transmitter "T" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
230–269	Company City	40	**Required.** Enter the city, town, or post office where correspondence should be sent.
270–271	Company State	2	**Required.** Enter the valid U.S. Postal Service state abbreviation. Refer to the chart for valid state codes in Part A, Sec. 14.
272–280	Company ZIP Code	9	**Required.** Enter the valid nine-digit ZIP assigned by the U.S. Postal Service. If only the first five-digits are known, left-justify information and fill unused positions with blanks.
281–295	Blank	15	Enter blanks.
296–303	Total Number of Payees	8	Enter the total number of Payee "B" Records reported in the file. Right-justify information and fill unused positions with zeros.
304–343	Contact Name	40	**Required.** Enter the name of the person to be contacted if IRS/ECC-MTB encounters problems with the file or transmission.
344–358	Contact Phone Number & Extension	15	**Required.** Enter the telephone number of the person to contact regarding electronic or magnetic files. Omit hyphens. If no extension is available, left-justify information and fill unused positions with blanks. For example, the IRS/ECC-MTB Customer Service Section phone number of **866–455–7438** with an extension of **52345** would be **866455743852345**.
359–408	Contact Email Address	50	**Required if available.** Enter the email address of the person to contact regarding electronic or magnetic files. Left-justify information. If no email address is available, enter blanks.
409–410	Cartridge Tape File Indicator	2	**Required for tape cartridge filers only.** Enter the letters "LS" (in uppercase only). Use of this field by filers using other types of media will be acceptable but is not required.
411–416	Transmitter's Media Number	6	For tape cartridge filers only. If your organization uses an in-house numbering system to identify tape cartridges, enter that number; otherwise, enter blanks.
417–499	Blank	83	Enter blanks.
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–517	Blank	10	Enter blanks.
518	Vendor Indicator	1	**Required.** Enter the appropriate code from the table below to indicate if your software was provided by a vendor or produced in-house. __Indicator__ — __Usage__ V — Your software was purchased from a vendor or other source. I — Your software was produced by in-house programmers.

Note: In-house programmer is defined as an employee or a hired contract programmer. If your software is produced in-house, the following Vendor information fields are not required.

Record Name: Transmitter "T" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
519–558	Vendor Name	40	**Required.** Enter the name of the company from whom you purchased your software.
559–598	Vendor Mailing Address	40	**Required.** Enter the mailing address.

For U.S. addresses, the vendor city, state, and ZIP Code must be reported as a 40, 2, and 9-position field, respectively. **Filers must adhere to the correct format for the payer city, state, and ZIP Code.**

For foreign addresses, filers may use the payer city, state, and ZIP Code as a continuous 51-position field. Enter information in the following order: city, province or state, postal code, and the name of the country.

599–638	Vendor City	40	**Required.** Enter the city, town, or post office.
639–640	Vendor State	2	**Required.** Enter the valid U.S. Postal Service state abbreviation. Refer to the chart of valid state codes in Part A, Sec. 14.
641–649	Vendor ZIP Code	9	**Required.** Enter the valid nine-digit ZIP Code assigned by the U.S. Postal Service. If only the first five-digits are known, left-justify information and fill unused positions with blanks.
650–689	Vendor Contact Name	40	**Required.** Enter the name of the person who can be contacted concerning any software questions.
690–704	Vendor Contact Phone Number & Extension	15	**Required.** Enter the telephone number of the person to contact concerning software questions. Omit hyphens. If no extension is available, left-justify information and fill unused positions with blanks.
705–739	Blank	35	Enter Blanks.
740	Vendor Foreign Entity Indicator	1	Enter a "1" (one) if the vendor is a foreign entity. Otherwise, enter a blank.
741–748	Blank	8	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed characters (CR/LF).

Sec. 3. Transmitter "T" Record — Record Layout

Record Type	Payment Year	Prior Year Data Indicator	Transmitter's TIN	Transmitter Control Code	Blank
1	2–5	6	7–15	16–20	21–27

Test File Indicator	Foreign Entity Indicator	Transmitter Name	Transmitter Name (Continuation)	Company Name	Company Name (Continuation)
28	29	30–69	70–109	110–149	150–189

Company Mailing Address	Company City	Company State	Company ZIP Code	Blank	Total Number of Payees	Contact Name
190–229	230–269	270–271	272–280	281–295	296–303	304–343

Contact Phone Number & Extension	Contact Email Address	Cartridge Tape File Indicator	Transmitter's Media Number	Blank	Record Sequence Number
344–358	359–408	409–410	411–416	417–499	500–507

Blank	Vendor Indicator	Vendor Name	Vendor Mailing Address	Vendor City	Vendor State
508–517	518	519–558	559–598	599–638	639–640

Vendor ZIP Code	Vendor Contact Name	Vendor Contact Phone Number & Extension	Blank	Vendor Foreign Entity Indicator	Blank	Blank or CR/LF
641–649	650–689	690–704	705–739	740	741–748	749–750

Sec. 4. Payer "A" Record — General Field Descriptions

.01 The Payer "A" Record identifies the person making payments, a recipient of mortgage or student loan interest payments, an educational institution, a broker, a person reporting a real estate transaction, a barter exchange, a creditor, a trustee or issuer of any IRA or MSA plan, and a lender who acquires an interest in secured property or who has a reason to know that the property has been abandoned. The payer will be held responsible for the completeness, accuracy, and timely submission of electronic/magnetic files.

.02 The second record on the file must be an "A" Record. A transmitter may include Payee "B" records for more than one payer in a file. However, **each group** of "B" records must be preceded by an "A" Record and followed by an End of Payer "C" Record. A single file may contain different types of returns but the types of returns **must not** be intermingled. A separate "A" Record is required for each payer and each type of return being reported.

.03 The number of "A" Records depends on the number of payers and the different types of returns being reported. Do not submit separate "A" Records for each payment amount being reported. For example, if a payer is filing Form 1099–DIV to report Amount Codes 1, 2, and 3, all three amount codes should be reported under one "A" Record, not three separate "A" Records.

.04 The maximum number of "A" Records allowed on a file is 90,000.

.05 All records must be a fixed length of 750 positions.

.06 All alpha characters entered in the "A" Record must be upper case.

.07 For all fields marked **"Required"**, the transmitter must provide the information described under Description and Remarks. For those fields not marked **"Required"**, a transmitter must allow for the field, but may be instructed to enter blanks or zeros in the indicated media position(s) and for the indicated length.

Record Name: Payer "A" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter an "A".
2–5	Payment Year	4	**Required.** Enter "*2007*". If reporting prior year data, report the year which applies (2005, 2006, etc.).
6–11	Blank	6	Enter blanks.
12–20	Payer's Taxpayer Identification Number (TIN)	9	**Required.** Must be the valid nine-digit Taxpayer Identification Number assigned to the payer. **Do not enter blanks, hyphens, or alpha characters.** All zeros, ones, twos, etc., will have the effect of an incorrect TIN.

Record Name: Payer "A" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
Note: For foreign entities that are not required to have a TIN, this field must be blank. However, the Foreign Entity Indicator, position 52 of the "A" Record, must be set to "1"(one).			
21–24	Payer Name Control	4	The Payer Name Control can be obtained only from the mail label on the Package 1099 that is mailed to most payers each December. Package 1099 contains Form 7018–C, Order Blank for Forms, and the mail label on the package contains a four (4) character name control. If a Package 1099 has not been received, you can determine your name control using the following simple rules or you can leave the field blank. For a business, use the first four significant characters of the business name. Disregard the word "the" when it is the first word of the name, unless there are only two words in the name. A dash (-) and an ampersand (&) are the only acceptable special characters. Names of less than four (4) characters should be left-justified, filling the unused positions with blanks.
25	Last Filing Indicator	1	Enter a "1" (one) if this is the **last year** this payer name and TIN will file information returns electronically, magnetically or on paper; otherwise, enter blank.
26	Combined Federal/State Filer	1	**Required for the Combined Federal/State Filing Program.** Enter "1" (one) if approved or submitting a test to participate in the Combined Federal/State Filing Program; otherwise, enter a blank.
Note: If the Payer "A" Record is coded for combined Federal/State filing there must be coding in the Payee "B" Records and the State Totals "K" Records.			
Note: If you entered "1" (one) in this field position, be sure to code the Payee "B" Records with the appropriate state code. Refer to Part A, Sec. 12, for further information.			
27	Type of Return	1	**Required.** Enter the appropriate code from the table below:

Type of Return	Code
1098	3
1098–C	X
1098–E	2
1098–T	8
1099–A	4
1099–B	B
1099–C	5
1099–CAP	P
1099–DIV	1
1099–G	F
1099–H	J
1099–INT	6
1099–LTC	T
1099–MISC	A
1099–OID	D
1099–PATR	7
1099–Q	Q
1099–R	9
1099–S	S
1099–SA	M
5498	L
5498–ESA	V
5498–SA	K
W–2G	W

Record Name: Payer "A" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
28–41	Amount Codes **(See Note.)**	14	**Required.** Enter the appropriate amount codes for the type of return being reported. In most cases, the box numbers on paper information returns correspond with the amount codes used to file electronically or magnetically. However, if discrepancies occur, this Revenue Procedure governs for filing electronically/magnetically. Enter the amount codes in ascending sequence; numeric characters followed by alphas. Left-justify, and fill unused positions with blanks.

Note: A type of return and an amount code must be present in every Payer "A" Record even if no money amounts are being reported. For a detailed explanation of the information to be reported in each amount code, refer to the appropriate paper instructions for each form.

Amount Codes **Form 1098** — Mortgage Interest Statement

For Reporting Mortgage Interest Received From Payers/Borrowers (Payer of Record) on Form 1098:

Amount Code	Amount Type
1	Mortgage interest received from payer(s)/borrower(s)
2	Points paid on purchase of principal residence
3	Refund (or credit) of overpaid interest
4	*Mortgage Insurance Premiums*
5	*Blank (Filer's use)*

Amount Codes **Form 1098–C** — Contributions of Motor Vehicles, Boats, and Airplanes

For Reporting Gross Proceeds From Sales on Form 1098–C:

Amount Code	Amount Type
4	Gross proceeds from sales
6	Value of goods or services in exchange for vehicle

Amount Code **Form 1098–E** — Student Loan Interest Statement

For Reporting Interest on Student Loans on Form 1098–E:

Amount Code	Amount Type
1	Student loan interest received by lender

Amount Codes **Form 1098–T** — Tuition Statement

For Reporting Tuition Payments on Form 1098–T:

Amount Code	Amount Type
1	Payments received for qualified tuition and related expenses
2	Amounts billed for qualified tuition and related expenses
3	Adjustments made for prior year
4	Scholarships or grants
5	Adjustments to scholarships or grants for a prior year
7	Reimbursements or refunds of qualified tuition and related expenses from an insurance contract

Record Name: Payer "A" Record (Continued)

Field Position	Field Title	Length	Description and Remarks

Note 1: For Amount Codes 1 and 2 enter either payments received OR amounts billed. DO NOT report both.

Note 2: Amount codes 3 and 5 are assumed to be negative. It is not necessary to code with an over punch or dash to indicate a negative reporting.

Amount Codes **Form 1099–A** — Acquisition or Abandonment of Secured Property

For Reporting the Acquisition or Abandonment of Secured Property on Form 1099–A:

Amount Code	Amount Type
2	Balance of principal outstanding
4	Fair market value of property

Amount Codes **Form 1099–B** — Proceeds From Broker and Barter Exchange Transactions

For Reporting Payments on Form 1099–B:

Amount Code	Amount Type
2	Stocks, bonds, etc. (For forward contracts, **See Note 1.**)
3	Bartering (Do not report negative amounts.)
4	Federal income tax withheld (backup withholding) (Do not report negative amounts.)
6	Profit (or loss) realized in *2007* **(See Note 2.)**
7	Unrealized profit (or loss) on open contracts - *12/31/2006* **(See Note 2.)**
8	Unrealized profit (or loss) on open contracts - *12/31/2007* **(See Note 2.)**
9	Aggregate profit (or loss) **(See Note 2.)**

Note 1: The payment amount field associated with Amount Code 2 may be used to report a loss from a closing transaction on a forward contract. Refer to the "B" Record – General Field Descriptions and Record Layouts, Payment Amount Fields, for instructions on reporting negative amounts.

Note 2: Payment Amount Fields 6, 7, 8, and 9 are to be used for the reporting of regulated futures or foreign currency contracts.

Amount Codes **Form 1099–C —** Cancellation of Debt

For Reporting Payments on Form 1099–C:

Amount Code	Amount Type
2	Amount of debt canceled
3	Interest, if included in Amount Code 2
7	Fair market value of property **(See Note.)**

Note: Use Amount Code 7 only if a combined Form 1099–A and 1099–C is being filed.

Amount Code **Form 1099–CAP** — Changes in Corporate Control and Capital Structure

For Reporting Payments on Form 1099–CAP:

Amount Code	Amount Type
2	Aggregate amount received

Amount Codes **Form 1099–DIV** — Dividends and Distributions

For Reporting Payments on Form 1099–DIV:

Amount Code	Amount Type
1	Total ordinary dividends
2	Qualified dividends
3	Total capital gain distribution

Record Name: Payer "A" Record (Continued)				
Field Position	**Field Title**	**Length**	**Description and Remarks**	
			<u>**Amount Code**</u>	<u>**Amount Type**</u>
			6	Unrecaptured Section 1250 gain
			7	Section 1202 gain
			8	Collectibles (28%) rate gain
			9	Nondividend distributions
			A	Federal income tax withheld
			B	Investment expenses
			C	Foreign tax paid
			D	Cash liquidation distributions
			E	Non-cash liquidation distributions
Amount Codes **Form 1099–G** — Certain Government Payments			For Reporting Payments on Form 1099–G:	
			<u>**Amount Code**</u>	<u>**Amount Type**</u>
			1	Unemployment compensation
			2	State or local income tax refunds, credits, or offsets
			4	Federal income tax withheld (backup withholding or voluntary withholding on unemployment compensation or Commodity Credit Corporation Loans, or certain crop disaster payments)
			5	Alternative Trade Adjustment Assistance (ATAA) Payments
			6	Taxable grants
			7	Agriculture payments
Amount Codes **Form 1099–H** — Health Coverage Tax Credit (HCTC) Advance Payments			For Reporting Payments on Form 1099–H:	
			<u>**Amount Code**</u>	<u>**Amount Type**</u>
			1	Gross amount of health insurance advance payments
			2	Amount of advance payment for January
			3	Amount of advance payment for February
			4	Amount of advance payment for March
			5	Amount of advance payment for April
			6	Amount of advance payment for May
			7	Amount of advance payment for June
			8	Amount of advance payment for July
			9	Amount of advance payment for August
			A	Amount of advance payment for September
			B	Amount of advance payment for October
			C	Amount of advance payment for November
			D	Amount of advance payment for December
Amount Codes **Form 1099–INT** — Interest Income			For Reporting Payments on Form 1099–INT:	
			<u>**Amount Code**</u>	<u>**Amount Type**</u>
			1	Interest income not included in Amount Code 3
			2	Early withdrawal penalty

Record Name: Payer "A" Record (Continued)				
Field Position	**Field Title**	**Length**	**Description and Remarks**	
			Amount Code	**Amount Type**
			3	Interest on U.S. Savings Bonds and Treasury obligations
			4	Federal income tax withheld (backup withholding)
			5	Investment expenses
			6	Foreign tax paid
			8	Tax-exempt interest
			9	Specified Private Activity Bond Interest
Amount Codes **Form 1099–LTC** — Long-Term Care and Accelerated Death Benefits			For Reporting Payments on Form 1099–LTC:	
			Amount Code	**Amount Type**
			1	Gross long-term care benefits paid
			2	Accelerated death benefits paid
Amount Codes **Form 1099–MISC** — Miscellaneous Income **(See Note 1.)**			For Reporting Payments on Form 1099–MISC:	
			Amount Code	**Amount Type**
			1	Rents
			2	Royalties **(See Note 2.)**
			3	Other income
			4	Federal income tax withheld (backup withholding or withholding on Indian gaming profits)
			5	Fishing boat proceeds
			6	Medical and health care payments
			7	Nonemployee compensation
			8	Substitute payments in lieu of dividends or interest
			A	Crop insurance proceeds
			B	Excess golden parachute payments
			C	Gross proceeds paid to an attorney in connection with legal services
			D	Section 409A Deferrals
			E	Section 409A Income

Note 1: If reporting a direct sales indicator *only*, use Type of Return "A" in Field Position 27, and Amount Code 1 in Field Position 28 of the Payer "A" Record. All payment amount fields in the Payee "B" Record will contain zeros.

Note 2: Do not report timber royalties under a "pay-as-cut" contract; these must be reported on Form 1099–S.

Amount Codes **Form 1099–OID** — Original Issue Discount			For Reporting Payments on Form 1099–OID:	
			Amount Code	**Amount Type**
			1	Original issue discount for *2007*
			2	Other periodic interest
			3	Early withdrawal penalty
			4	Federal income tax withheld (backup withholding)
			6	Original issue discount on U.S. Treasury Obligations
			7	Investment expenses

Record Name: Payer "A" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**

Amount Codes **Form 1099–PATR** — Taxable Distributions Received From Cooperatives

For Reporting Payments on Form 1099–PATR:

Amount Code	Amount Type
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld (backup withholding)
5	Redemption of nonqualified notices and retain allocations
6	Deduction for qualified production activities income
Pass-Through Credits	
7	Investment credit
8	Work opportunity credit
9	Patron's alternative minimum tax (AMT) adjustment
A	For filer's use for pass-through credits and deductions

Amount Codes **Form 1099–Q** — Payments From Qualified Education Programs (Under Sections 529 and 530)

For Reporting Payments on a Form 1099–Q:

Amount Code	Amount Type
1	Gross distribution
2	Earnings
3	Basis

Amount Codes **Form 1099–R** — Distributions From Pensions, Annuities, Retirement or Profit–Sharing Plans, IRAs, Insurance Contracts, etc.

For Reporting Payments on Form 1099–R:

Amount Code	Amount Type
1	Gross distribution
2	Taxable amount **(See Note 1.)**
3	Capital gain (included in Amount Code 2)
4	Federal income tax withheld
5	Employee contributions or insurance premiums
6	Net unrealized appreciation in employer's securities
8	Other
9	Total employee contributions
A	Traditional IRA/SEP/SIMPLE distribution or Roth conversion **(See Note 2.)**

Note 1: **If the taxable amount cannot be determined, enter a "1" (one) in position 547 of the "B" Record. Payment Amount 2 must contain zeros.**

Note 2: **For Form 1099–R, report the Roth conversion or total amount distributed from an IRA, SEP, or SIMPLE in Payment Amount Field A (IRA/SEP/SIMPLE distribution or Roth conversion) of the Payee "B" Record, and generally, the same amount in Payment Amount Field 1 (Gross Distribution). The IRA/SEP/SIMPLE indicator should be set to "1" (one) in Field Position 548 of the Payee "B" Record.**

Record Name: Payer "A" Record (Continued)

Field Position	Field Title	Length	Description and Remarks	
Amount Codes **Form 1099–S** — Proceeds From Real Estate Transactions			For Reporting Payments on Form 1099–S:	
			Amount Code	**Amount Type**
			2	Gross proceeds **(See Note.)**
			5	Buyer's part of real estate tax

Note: Include payments of timber royalties made under a "pay-as-cut" contract, reportable under IRC section 6050N. If timber royalties are being reported, enter "TIMBER" in the description field of the "B" Record.

Field Position	Field Title	Length	Description and Remarks	
Amount Codes **Form 1099–SA —** Distributions From an HSA, Archer MSA or Medicare Advantage MSA			For Reporting Distributions on Form 1099–SA:	
			Amount Code	**Amount Type**
			1	Gross distribution
			2	Earnings on excess contributions
			4	Fair market value of the account on date of death
Amount Codes **Form 5498** — IRA Contribution Information			For Reporting Information on Form 5498:	
			Amount Code	**Amount Type**
			1	IRA contributions (other than amounts in Amount Codes 2, 3, 4, 8, 9, and A) **(See Notes 1 and 2.)**
			2	Rollover contributions
			3	Roth conversion amount
			4	Recharacterized contributions
			5	Fair market value of account
			6	Life insurance cost included in Amount Code 1
			8	SEP contributions
			9	SIMPLE contributions
			A	Roth IRA contributions

Note 1: If reporting IRA contributions for a participant in a military operation, see *2007 Instructions for Forms 1099–R and 5498.*

Note 2: Also include employee contributions to an IRA under a SEP plan but not salary reduction contributions. DO NOT include EMPLOYER contributions; these are included in Amount Code 8.

Field Position	Field Title	Length	Description and Remarks	
Amount Codes **Form 5498–ESA** — Coverdell ESA Contribution Information			For Reporting Information on Form 5498–ESA:	
			Amount Code	**Amount Type**
			1	Coverdell ESA contributions
			2	Rollover contributions
Amount Codes **Form 5498–SA** — HSA, Archer MSA, or Medicare Advantage MSA Information			For Reporting Information on Form 5498–SA:	
			Amount Code	**Amount Type**
			1	Employee or self-employed person's Archer MSA contributions made in 2007 and 2008 for 2007
			2	Total contributions made in 2007 (See current 2007 Instructions.)
			3	Total HSA/MSA contributions made in 2008 for 2007
			4	Rollover contributions **(See Note.)**

Record Name: Payer "A" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
			<u>**Amount Code**</u> — <u>**Amount Type**</u> 5 — Fair market value of HSA, Archer MSA or Medicare Advantage MSA account on Dec. 31, 2007

Note: This is the amount of any rollover made to this MSA in *2007* after a distribution from another MSA. For detailed information on reporting, see the *2007 Instructions for Forms 1099–SA and 5498–SA*.

Amount Codes **Form W–2G** — Certain Gambling Winnings			For Reporting Payments on Form W–2G: <u>**Amount Code**</u> — <u>**Amount Type**</u> 1 — Gross winnings 2 — Federal income tax withheld 7 — Winnings from identical wagers
42–51	Blank	10	Enter blanks.
52	Foreign Entity Indicator	1	Enter a "1" (one) if the payer is a foreign entity and income is paid by the foreign entity to a U.S. resident. Otherwise, enter a blank.
53–92	First Payer Name Line	40	**Required.** Enter the name of the payer whose TIN appears in positions 12–20 of the "A" Record. Any extraneous information must be deleted. Left-justify information, and fill unused positions with blanks. (Filers should not enter a transfer agent's name in this field. Any transfer agent's name should appear in the Second Payer Name Line Field.)
93–132	Second Payer Name Line	40	If the Transfer (or Paying) Agent Indicator (position 133) contains a "1" (one), this field must contain the name of the transfer (or paying) agent. If the indicator contains a "0" (zero), this field may contain either a continuation of the First Payer Name Line or blanks. Left-justify information and fill unused positions with blanks.
133	Transfer Agent Indicator	1	**Required.** Identifies the entity in the Second Payer Name Line Field. <u>**Code**</u> — <u>**Meaning**</u> 1 — The entity in the Second Payer Name Line Field is the transfer (or paying) agent. 0 (zero) — The entity shown is **not** the transfer (or paying) agent (i.e., the Second Payer Name Line Field contains either a continuation of the First Payer Name Line Field or blanks).
134–173	Payer Shipping Address	40	**Required.** If the Transfer Agent Indicator in position 133 is a "1" (one), enter the shipping address of the transfer (or paying) agent. Otherwise, enter the **actual** shipping address of the payer. The street address should include number, street, apartment or suite number, or PO Box if mail is not delivered to a street address. Left-justify information, and fill unused positions with blanks.

For U.S. addresses, the payer city, state, and ZIP Code must be reported as a 40, 2, and 9-position field, respectively. **Filers must adhere to the correct format for the payer city, state, and ZIP Code.**

For foreign addresses, filers may use the payer city, state, and ZIP Code as a continuous 51-position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Entity Indicator in position 52 must contain a "1" (one).

174–213	Payer City	40	**Required.** If the Transfer Agent Indicator in position 133 is a "1" (one), enter the city, town, or post office of the transfer agent. Otherwise, enter the city, town, or post office of the payer. Left-justify information, and fill unused positions with blanks. Do not enter state and ZIP Code information in this field.

Record Name: Payer "A" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
214–215	Payer State	2	**Required**. Enter the valid U.S. Postal Service state abbreviations. Refer to the chart of valid state abbreviations in Part A, Sec. 14.
216–224	Payer ZIP Code	9	**Required.** Enter the valid nine-digit ZIP Code assigned by the U.S. Postal Service. If only the first five-digits are known, left-justify information and fill the unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Entity Indicator, located in Field Position 52 of the "A" Record.
225–239	Payer's Phone Number & Extension	15	Enter the payer's phone number and extension. Omit hyphens. Left-justify information and fill unused positions with blanks.
240–499	Blank	260	Enter blanks.
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–748	Blank	241	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Sec. 5. Payer "A" Record — Record Layout

Record Type	Payment Year	Blank	Payer TIN	Payer Name Control	Last Filing Indicator
1	2–5	6–11	12–20	21–24	25

Combined Federal/State Filer	Type of Return	Amount Codes	Blank	Foreign Entity Indicator	First Payer Name Line
26	27	28–41	42–51	52	53–92

Second Payer Name Line	Transfer Agent Indicator	Payer Shipping Address	Payer City	Payer State	Payer ZIP Code
93–132	133	134–173	174–213	214–215	216–224

Payer's Phone Number and Extension	Blank	Record Sequence Number	Blank	Blank or CR/LF
225–239	240–499	500–507	508–748	749–750

Sec. 6. Payee "B" Record — General Field Descriptions and Record Layouts

.01 The "B" Record contains the payment information from the information returns. The record layout for field positions 1 through 543 is the same for all types of returns. Field positions 544 through 750 vary for each type of return to accommodate special fields for individual forms. In the "B" Record, the filer **must** allow for all **fourteen** Payment Amount Fields. **For those fields not used, enter "0s" (zeros).**

.02 The following specifications include a field in the payee records called "Name Control" in which the first four characters of the payee's surname are to be entered by the filer:

(a) If filers are unable to determine the first four characters of the surname, the Name Control Field may be left blank. Compliance with the following will facilitate IRS computer programs in identifying the correct name control:

(1) The surname of the payee whose TIN is shown in the "B" Record should always appear first. If, however, the records have been developed using the first name first, the filer must leave a blank space between the first and last names.

(2) In the case of multiple payees, the surname of the payee whose TIN (SSN, EIN, ITIN, or ATIN) is shown in the "B" Record must be present in the First Payee Name Line. Surnames of any other payees may be entered in the Second Payee Name Line.

.03 For all fields marked **"Required"**, the transmitter must provide the information described under "Description and Remarks". For those fields not marked **"Required"**, the transmitter must allow for the field, but may be instructed to enter blanks or zeros in the indicated field position(s) and for the indicated length.

.04 All records must be a fixed length of 750 positions.

.05 A field is also provided in these specifications for Special Data Entries. This field may be used to record information required by state or local governments, or for the personal use of the filer. IRS does not use the data provided in the Special Data Entries Field; therefore, the IRS program does not check the content or format of the data entered in this field. It is the filer's option to use the Special Data Entry Field.

.06 Following the Special Data Entries Field in the "B" Record, payment fields have been allocated for State Income Tax Withheld and Local Income Tax Withheld. These fields are for the convenience of the filers. The information will not be used by IRS/ECC-MTB.

.07 Those payers participating in the Combined Federal/State Filing Program must adhere to all of the specifications in Part A, Sec. 12, to participate in this program.

.08 All alpha characters in the "B" Record must be uppercase.

.09 **Do not** use decimal points (.) to indicate dollars and cents. Payment Amount Fields must be all numeric characters.

Record Name: Payee "B" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "B".
2–5	Payment Year	4	**Required.** Enter "*2007*". If reporting prior year data, report the year which applies (2005, 2006, etc.).
6	Corrected Return Indicator **(See Note.)**	1	**Required for corrections only.** Indicates a corrected return. __Code__ — __Definition__ G — If this is a one-transaction correction or the first of a two-transaction correction C — If this is the second transaction of a two-transaction correction Blank — If this is not a return being submitted to correct information already processed by IRS

Note: C, G, and non-coded records must be reported using separate Payer "A" Records. Refer to Part A, Sec. 10, for specific instructions on how to file corrected returns.

Record Name: Payee "B" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
7–10	Name Control	4	If determinable, enter the first four characters of the surname of the person whose TIN is being reported in positions 12-20 of the "B" Record; otherwise, **enter blanks**. This usually is the payee. If the name that corresponds to the TIN is not included in the first or second payee name line and the correct name control is not provided, a backup withholding notice may be generated for the record. Surnames of less than four characters should be left-justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. In the case of a business, other than a sole proprietorship, use the first four significant characters of the business name. Disregard the word "the" when it is the first word of the name, unless there are only two words in the name. A dash (-) and an ampersand (&) are the only acceptable special characters. Surname prefixes are considered, e.g., for Van Elm, the name control would be VANE. For a sole proprietorship, use the name of the owner to create the name control and report the owner's name in positions 248–287, First Payee Name Line.

Note: Imbedded blanks, extraneous words, titles, and special characters (i.e., Mr., Mrs., Dr., period [.], apostrophe [']) should be removed from the Payee Name Lines. A dash (-) and an ampersand (&) are the only acceptable special characters.

The following examples may be helpful to filers in developing the Name Control:

Name	Name Control
Individuals:	
Jane **Brow**n	BROW
John A. **Lee**	LEE*
James P. **En**, Sr.	EN*
John **O'Nei**l	ONEI
Mary **Van B**uren	VANB
Juan **De Je**sus	DEJE
Gloria A. **El-R**oy	EL-R
Mr. John **Smit**h	SMIT
Joe **McCa**rthy	MCCA
Pedro **Torr**es-Lopes**	TORR
Maria **Lope**z Moreno**	LOPE
Binh To **La**	LA*
Nhat Thi **Pham**	PHAM
Corporations:	
The **Firs**t National Bank	FIRS
The Hideaway	THEH
A&B Cafe	A&BC
11TH Street Inc.	11TH
Sole Proprietor:	
Mark **Heml**ock DBA The Sunshine Club	HEML
Mark **D'All**esandro	DALL

Record Name: Payee "B" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
Partnership:			
	Robert **Aspe**n and Bess Willow	ASPE	
	Harold **Fir**, Bruce Elm, and Joyce Spruce et al Ptr	FIR*	
Estate:			
	Frank **Whit**e Estate	WHIT	
	Estate of Sheila **Blue**	BLUE	
Trusts and Fiduciaries:			
	Daisy Corporation Employee Benefit Trust	DAIS	
	Trust FBO The **Cher**ryblossom Society	CHER	
Exempt Organizations:			
	Laborer's Union, AFL-CIO	LABO	
	St. Bernard's Methodist Church Bldg. Fund	STBE	

*Name Controls of less than four significant characters must be left-justified and blank-filled.
**For Hispanic names, when two last names are shown for an individual, derive the name control from the first last name.

Field Position	Field Title	Length	Description and Remarks
11	Type of TIN	1	This field is used to identify the Taxpayer Identification Number (TIN) in positions 12–20 as either an Employer Identification Number (EIN), a Social Security Number (SSN), an Individual Taxpayer Identification Number (ITIN) or an Adoption Taxpayer Identification Number (ATIN). Enter the appropriate code from the following table:
12–20	Payee's Taxpayer Identification Number (TIN)	9	**Required.** Enter the nine-digit Taxpayer Identification Number of the payee (SSN, ITIN, ATIN, or EIN). If an identification number has been applied for but not received, enter blanks. **Do not enter hyphens or alpha characters.** All zeros, ones, twos, etc., will have the effect of an incorrect TIN. If the TIN is not available, enter blanks.

Type of TIN codes (field position 11):

Code	Type of TIN	Type of Account
1	EIN	A business, organization, some sole proprietors, or other entity
2	SSN	An individual, including some sole proprietors
2	ITIN	An individual required to have a taxpayer identification number, but who is not eligible to obtain an SSN
2	ATIN	An adopted individual prior to the assignment of a social security number
Blank	N/A	If the type of TIN is not determinable, enter a blank

Record Name: Payee "B" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
Note: If you are required to report payments made through Foreign Intermediaries and Foreign Flow-Through Entities on Form 1099, see the ***2007 General Instructions for Forms 1099, 1098, 5498 and W–2G*** **for reporting requirements.**			
21–40	Payer's Account Number For Payee	20	**Required if submitting more than one information return of the same type for the same payee.** Enter any number assigned by the payer to the payee that can be used by the IRS to distinguish between information returns. This number must be unique for each information return of the same type for the same payee. If a payee has more than one reporting of the same document type, it is vital that each reporting have a unique account number. For example, if a payer has 3 separate pension distributions for the same payee and 3 separate Forms 1099–R are filed, 3 separate unique account numbers are required. A payee's account number may be given a unique sequencing number, such as 01, 02 or A, B, etc., to differentiate each reported information return. Do not use the payee's TIN since this will not make each record unique. This information is critical when corrections are filed. This number will be provided with the backup withholding notification and may be helpful in identifying the branch or subsidiary reporting the transaction. The account number can be any combination of alpha, numeric or special characters. If fewer than twenty characters are used, filers may either left or right-justify, filling the remaining positions with blanks.
41–44	Payer's Office Code	4	Enter office code of payer; otherwise, enter blanks. For payers with multiple locations, this field may be used to identify the location of the office submitting the information return. This code will also appear on backup withholding notices.
45–54	Blank	10	Enter blanks.
	Payment Amount Fields (Must be numeric)		**Required. Filers should allow for all payment amounts. For those not used, enter zeros.** Each payment field must contain 12 numeric characters. Each payment amount must contain U.S. dollars and cents. The right-most two positions represent cents in the payment amount fields. **Do not enter dollar signs, commas, decimal points, or negative payments, except those items that reflect a loss on Form 1099–B or 1099–Q.** Positive and negative amounts are indicated by placing a "+" (plus) or "-" (minus) sign in the left-most position of the payment amount field. A negative over punch in the unit's position may be used, instead of a minus sign, to indicate a negative amount. If a plus sign, minus sign, or negative over punch is not used, the number is assumed to be positive. Negative over punch cannot be used in PC created files. Payment amounts must be right-justified and unused positions must be zero filled.
55–66	Payment Amount 1*	12	The amount reported in this field represents payments for Amount Code 1 in the "A" Record.
67–78	Payment Amount 2*	12	The amount reported in this field represents payments for Amount Code 2 in the "A" Record.
79–90	Payment Amount 3*	12	The amount reported in this field represents payments for Amount Code 3 in the "A" Record.
91–102	Payment Amount 4*	12	The amount reported in this field represents payments for Amount Code 4 in the "A" Record.
103–114	Payment Amount 5*	12	The amount reported in this field represents payments for Amount Code 5 in the "A" Record.

Record Name: Payee "B" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
115–126	Payment Amount 6*	12	The amount reported in this field represents payments for Amount Code 6 in the "A" Record.
127–138	Payment Amount 7*	12	The amount reported in this field represents payments for Amount Code 7 in the "A" Record.
139–150	Payment Amount 8*	12	The amount reported in this field represents payments for Amount Code 8 in the "A" Record.
151–162	Payment Amount 9*	12	The amount reported in this field represents payments for Amount Code 9 in the "A" Record.
163–174	Payment Amount A*	12	The amount reported in this field represents payments for Amount Code A in the "A" Record.
175–186	Payment Amount B*	12	The amount reported in this field represents payments for Amount Code B in the "A" Record.
187–198	Payment Amount C*	12	The amount reported in this field represents payments for Amount Code C in the "A" Record.
199–210	Payment Amount D*	12	The amount reported in this field represents payments for Amount Code D in the "A" Record.
211–222	Payment Amount E*	12	The amount reported in this field represents payments for Amount Code E in the "A" Record.
***If there are discrepancies between the payment amount fields and the boxes on the paper forms, the instructions in this Revenue Procedure must be followed for electronic/magnetic filing.**			
223–246	Reserved	24	Enter blanks.
247	Foreign Country Indicator	1	**If the address of the payee is in a foreign country, enter a "1" (one) in this field**; otherwise, enter blank. When filers use this indicator, they may use a free format for the payee city, state, and ZIP Code. Enter information in the following order: city, province or state, postal code, and the name of the country. Address information must not appear in the First or Second Payee Name Line.
248–287	First Payee Name Line	40	**Required.** Enter the name of the payee (preferably surname first) whose Taxpayer Identification Number (TIN) was provided in positions 12–20 of the Payee "B" Record. Left-justify and fill unused positions with blanks. If more space is required for the name, use the Second Payee Name Line Field. If reporting information for a sole proprietor, the individual's name must always be present on the First Payee Name Line. The use of the business name is optional in the Second Payee Name Line Field. End the First Payee Name Line with a full word. Use appropriate spacing. Extraneous words, titles, and special characters (i.e., Mr., Mrs., Dr., period, apostrophe) should be removed from the Payee Name Lines. A dash (-) and an ampersand (&) are the only acceptable special characters for First and Second Payee Name Lines.
Note: If you are required to report payments made through Foreign Intermediaries and Foreign Flow-Through Entities on Form 1099, see the *2007 General Instruction for Forms 1099, 1098, 5498, and W–2G* for reporting requirements.			

Record Name: Payee "B" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
288–327	Second Payee Name Line	40	If there are multiple payees (e.g., partners, joint owners, or spouses), use this field for those names not associated with the TIN provided in positions 12–20 of the "B" Record, or if not enough space was provided in the First Payee Name Line, continue the name in this field. Left-justify information and fill unused positions with blanks. **Do not enter address information.** It is important that filers provide as much payee information to IRS/ECC-MTB as possible to identify the payee associated with the TIN. Left-justify and fill unused positions with blanks. **See Note above in First Payee Name Line.**
328–367	Blank	40	Enter blanks.
368–407	Payee Mailing Address	40	**Required.** Enter mailing address of payee. Street address should include number, street, apartment or suite number, or PO Box if mail is not delivered to street address. This field **must not** contain any data other than the payee's mailing address.
408–447	Blank	40	Enter blanks.
448–487	Payee City	40	**Required.** Enter the city, town or post office. Left-justify information and fill the unused positions with blanks. Enter APO or FPO if applicable. Do not enter state and ZIP Code information in this field.
488–489	Payee State	2	**Required**. Enter the valid U.S. Postal Service state abbreviations for states or the appropriate postal identifier (AA, AE, or AP) described in Part A, Sec. 14.
490–498	Payee ZIP Code	9	**Required.** Enter the valid ZIP Code (nine or five-digit) assigned by the U.S. Postal Service. If only the first five-digits are known, left-justify information and fill the unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Country Indicator, located in position 247 of the "B" Record.
499	Blank	1	Enter blank.
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–543	Blank	36	Enter blanks.

Standard Payee "B" Record Format For All Types of Returns, Positions 1–543

Record Type	Payment Year	Corrected Return Indicator	Name Control	Type of TIN	Payee's TIN	Payer's Account Number For Payee
1	2–5	6	7–10	11	12–20	21–40

Payer's Office Code	Blank	Payment Amount 1	Payment Amount 2	Payment Amount 3	Payment Amount 4	Payment Amount 5
41–44	45–54	55–66	67–78	79–90	91–102	103–114

Payment Amount 6	Payment Amount 7	Payment Amount 8	Payment Amount 9	Payment Amount A	Payment Amount B
115–126	127–138	139–150	151–162	163–174	175–186

Payment Amount C	Payment Amount D	Payment Amount E	Reserved	Foreign Country Indicator	First Payee Name Line	Second Payee Name Line	Blank
187–198	199–210	211–222	223–246	247	248–287	288–327	328–367

Payee Mailing Address	Blank	Payee City	Payee State	Payee ZIP Code	Blank	Record Sequence Number	Blank
368–407	408–447	448–487	488–489	490–498	499	500–507	508–543

The following sections define the field positions for the different types of returns in the Payee "B" Record (positions 544–750):

(1) Form 1098
(2) Form 1098–C
(3) Form 1098–E
(4) Form 1098–T
(5) Form 1099–A
(6) Form 1099–B
(7) Form 1099–C
(8) Form 1099–CAP
(9) Form 1099–DIV*
(10) Form 1099–G*
(11) Form 1099–H
(12) Form 1099–INT*
(13) Form 1099–LTC
(14) Form 1099–MISC*
(15) Form 1099–OID*
(16) Form 1099–PATR*
(17) Form 1099–Q
(18) Form 1099–R*
(19) Form 1099–S

(20) Form 1099–SA
(21) Form 5498*
(22) Form 5498–ESA
(23) Form 5498–SA
(24) Form W–2G

* These forms may be filed through the Combined Federal/State Filing Program. IRS/ECC-MTB will forward these records to participating states for filers who have been approved for the program. See Part A, Sec. 12, for information about the program, including specific codes for the record layouts.

(1) Payee "B" Record — Record Layout Positions 544–750 for Form 1098

Field Position	Field Title	Length	Description and Remarks
544–662	Blank	119	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1098

Blank	Special Data Entries	Blank	Blank or CR/LF
544–662	663–722	723–748	749–750

(2) Payee "B" Record — Record Layout Positions 544–750 for Form 1098–C

Field Position	Field Title	Length	Description and Remarks
544–545	Blank	2	Enter blanks.
546	Transaction Indicator	1	Enter "1" (one) if the amount reported in Payment Amount Field 4 is an arm's length transaction to an unrelated party. Otherwise, enter a blank.
547	Transfer After Improvements Indicator	1	Enter "1" (one) if the vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use. Otherwise, enter a blank.
548	Transfer Below Fair Market Value Indicator	1	Enter "1" (one) if the vehicle is transferred to a needy individual for significantly below fair market value. Otherwise, enter a blank.
549–587	Make, Model, Year	39	Enter the make, model and year of vehicle. Left-justify and fill unused positions with blanks.
588–612	Vehicle or Other Identification Number	25	Enter the vehicle or other identification number of the donated vehicle. Left-justify and fill unused positions with blanks.
613–651	Vehicle Description	39	Enter a description of material improvements or significant intervening use and duration of use. Left-justify and fill unused positions with blanks.

(2) Payee "B" Record — Record Layout Positions 544–750 for Form 1098–C (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
652–659	Date of Contribution	8	Enter the date the contribution was made to an organization, in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
660	Donee Indicator	1	Enter the appropriate indicator from the following table to report if the donee of the vehicle provides goods or services in exchange for the vehicle. __Indicator__ — __Usage__ 1 — Donee provided goods or services 2 — Donee did not provide goods or services
661	Intangible Religious Benefits Indicator	1	Enter a "1" (one) if only intangible religious benefits were provided in exchange for the vehicle; otherwise, leave blank.
662	Deduction $500 or Less Indicator	1	Enter a "1" (one) if under law donor cannot claim a deduction of more than $500 for the vehicle; otherwise, leave blank.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, enter blanks.
723–730	Date of Sale	8	Enter the date of sale, in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
731–748	Goods and Services	18	Enter a description of any goods and services received for the vehicle; otherwise, leave blank. Left-justify and fill unused positions with blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1098–C

Blank	Transaction Indicator	Transfer After Improvements Indicator	Transfer Below Fair Market Value Indicator	Make, Model, Year	Vehicle or Other Identification Number	Vehicle Description
544–545	546	547	548	549–587	588–612	613–651

Date of Contribution	Donee Indicator	Intangible Religious Benefits Indicator	Deduction $500 or Less Indicator	Special Data Entries	Date of Sale	Goods and Services	Blank
652–659	660	661	662	663–722	723–730	731–748	749–750

(3) Payee "B" Record — Record Layout Positions 544–750 for Form 1098–E

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Origination Fees/Capitalized Interest Indicator	1	Enter "1" (one) if the amount reported in Payment Amount Field 1 includes loan origination fees and/or capitalized interest. Otherwise, enter a blank.
548–662	Blank	115	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1098–E

Blank	Origination Fees/Capitalized Interest Indicator	Blank	Special Data Entries	Blank	Blank or CR/LF
544–546	547	548–662	663–722	723–748	749–750

(4) Payee "B" Record — Record Layout Positions 544–750 for Form 1098–T

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Half-time Student Indicator	1	Enter "1" (one) if the student was at least a half-time student during any academic period that began in 2007. Otherwise, enter a blank.
548	Graduate Student Indicator	1	Enter "1" (one) if the student is enrolled exclusively in a graduate level program. Otherwise, enter a blank.
549	Academic Period Indicator	1	Enter "1" (one) if the amount in Payment Amount Field 1 or Payment Amount Field 2 includes amounts for an academic period beginning January through March 2008. Otherwise, enter a blank.
550	*Method of Reporting 2006 Amounts Indicator*	*1*	***Required.*** *Enter "1" (one) if the method of reporting has changed from the previous year. Otherwise, enter a blank.*
551–662	Blank	112	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1098–T

Blank	Half-time Student Indicator	Graduate Student Indicator	Academic Period Indicator	*Method of Reporting 2006 Amounts Indicator*
544–546	547	548	549	*550*

Blank	Special Data Entries	Blank	Blank or CR/LF
551–662	663–722	723–748	749–750

(5) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–A

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Personal Liability Indicator	1	Enter the appropriate indicator from the table below: **Indicator** — **Usage** 1 — Borrower was personally liable for repayment of the debt. Blank — Borrower was not personally liable for repayment of the debt.
548–555	Date of Lender's Acquisition or Knowledge of Abandonment	8	Enter the acquisition date of the secured property or the date the lender first knew or had reason to know the property was abandoned, in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
556–594	Description of Property	39	Enter a brief description of the property. For real property, enter the address, or, if the address does not sufficiently identify the property, enter the section, lot and block. For personal property, enter the type, make and model (e.g., Car-1999 Buick Regal or Office Equipment). Enter "CCC" for crops forfeited on Commodity Credit Corporation loans. If fewer than 39 positions are required, left-justify information and fill unused positions with blanks.
595–662	Blank	68	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks, or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–A

Blank	Personal Liability Indicator	Date of Lender's Acquisition or Knowledge of Abandonment	Description of Property	Blank
544–546	547	548–555	556–594	595–662

Special Data Entries	Blank	Blank or CR/LF
663–722	723–748	749–750

(6) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–B

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–546	Blank	2	Enter blanks.
547	Gross Proceeds Indicator	1	Enter the appropriate indicator from the following table, to identify the amount reported in Amount Code 2; otherwise, enter a blank. **Indicator** — **Usage** 1 — Gross proceeds 2 — Gross proceeds less commissions and options premiums
548–555	Date of Sale or Exchange	8	For broker transactions, enter the trade date of the transaction. For barter exchanges, enter the date when cash, property, a credit, or scrip is actually or constructively received in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). Enter blanks if this is an aggregate transaction. **Do not enter hyphens or slashes.**
556–568	CUSIP Number	13	For broker transactions only, enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the item reported for Amount Code 2 (stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0s" (zeros) if the number is not available. Right-justify information and fill unused positions with blanks.
569–607	Description	39	If fewer than 39 characters are required, left-justify information and fill unused positions with blanks. For broker transactions, enter a brief description of the disposition item (e.g., 100 shares of XYZ Corp). For regulated futures and forward contracts, enter "RFC" or other appropriate description. For bartering transactions, show the services or property provided.
608–615	Number of Shares Exchanged	8	Enter the number of shares of the corporation's stock which were exchanged in the transaction. Report whole number only. Right-justify information and fill unused positions with zeros.

(6) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–B (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
616–625	Classes of Stock Exchanged	10	Enter the class of stock that was exchanged. Left-justify the information and fill unused positions with blanks.
626	Recipient Indicator	1	Enter a "1" (one) if recipient is unable to claim a loss on their tax return. Otherwise, enter a blank.
627–662	Blank	36	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks. **(See Note.)**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries field.
747–748	Blank	2	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Note: Report the Corporation's Name, Address, City, State, and ZIP in the Special Data Entry field.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–B

Second TIN Notice (Optional)	Blank	Gross Proceeds Indicator	Date of Sale or Exchange	CUSIP Number	Description	Number of Shares Exchanged
544	545–546	547	548–555	556–568	569–607	608–615

Classes of Stock Exchanged	Recipient Indicator	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
616–625	626	627–662	663–722	723–734	735–746	747–748	749–750

(7) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–C			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–546	Blank	3	Enter blanks.
547	Bankruptcy Indicator	1	Enter "1" (one) to indicate the debt was discharged in bankruptcy, if known. Otherwise, enter a blank.
548–555	Date Canceled	8	Enter the date the debt was canceled in the format of YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
556–594	Debt Description	39	Enter a description of the origin of the debt, such as student loan, mortgage, or credit card expenditure. If a combined Form 1099–C and 1099–A is being filed, also enter a description of the property.
595–662	Blank	68	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–C

Blank	Bankruptcy Indicator	Date Canceled	Debt Description	Blank	Special Data Entries
544–546	547	548–555	556–594	595–662	663–722

Blank	Blank or CR/LF
723–748	749–750

(8) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–CAP			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–547	Blank	4	Enter blanks.
548–555	Date of Sale or Exchange	8	Enter the date the stock was exchanged for cash, stock in the successor corporation, or other property received in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
556–607	Blank	52	Enter blanks.
608–615	Number of Shares Exchanged	8	Enter the number of shares of the corporation's stock which were exchanged in the transaction. Report whole number only. Right-justify information and fill unused positions with zeros.
616–625	Classes of Stock Exchanged	10	Enter the class of stock that was exchanged. Left-justify the information and fill unused positions with blanks.

(8) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–CAP (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
626	Blank	1	Enter a blank.
627	Shareholder Indicator	1	Enter a "1" (one) if the shareholder cannot take a loss on their tax return. Otherwise, enter a blank.
628–662	Blank	35	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–CAP

Blank	Date of Sale or Exchange	Blank	Number of Shares Exchanged	Classes of Stock Exchanged
544–547	548–555	556–607	608–615	616–625

Blank	Shareholder Indicator	Blank	Special Data Entries	Blank	Blank or CR/LF
626	627	628–662	663–722	723–748	749–750

(9) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–DIV			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–546	Blank	2	Enter blanks.
547–586	Foreign Country or U.S. Possession	40	Enter the name of the foreign country or U.S. possession to which the withheld foreign tax (Amount Code C) applies. Otherwise, enter blanks.
587–662	Blank	76	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.

(9) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–DIV (Continued)

Field Position	Field Title	Length	Description and Remarks
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–DIV

Second TIN Notice (Optional)	Blank	Foreign Country or U.S. Possession	Blank	Special Data Entries
544	545–546	547–586	587–662	663–722

State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
723–734	735–746	747–748	749–750

(10) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–G

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Trade or Business Indicator	1	Enter "1" (one) to indicate the state or local income tax refund, credit, or offset (Amount Code 2) is attributable to income tax that applies exclusively to income from a trade or business. <u>Indicator</u> — <u>Usage</u> 1 — Income tax refund applies exclusively to a trade or business. Blank — Income tax refund is a general tax refund.
548–551	Tax Year of Refund	4	Enter the tax year for which the refund, credit, or offset (Amount Code 2) was issued. **The tax year must reflect the tax year for which the payment was made, not the tax year of Form 1099–G. The tax year must be in the four-position format of YYYY (e.g., 2007).** The valid range of years for the refund is 1997 through 2006.
Note: This data is not considered prior year data since it is required to be reported in the current tax year. Do NOT enter "P" in field position 6 of the Transmitter "T" Record.			
552–662	Blank	111	Enter blanks.

(10) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–G (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. You may enter your routing and transit number (RTN) here. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–G

Blank	Trade or Business Indicator	Tax Year of Refund	Blank	Special Data Entries	State Income Tax Withheld
544–546	547	548–551	552–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
735–746	747–748	749–750

(11) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–H			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–546	Blank	3	Enter blanks.
547–548	Number of Months Eligible	2	**Required.** Enter the total number of months recipient is eligible for health insurance advance payments. Right-justify and blank fill any remaining position.
549–662	Blank	114	Enter blanks.

(11) Payee "B" Record — Record Layout Positions 544–750 for Form 1099-H (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099-H

Blank	Number of Months Eligible	Blank	Special Data Entries	Blank	Blank or CR/LF
544–546	547–548	549–662	663–722	723–748	749–750

(12) Payee "B" Record — Record Layout Positions 544–750 for Form 1099-INT			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–546	Blank	2	Enter blanks.
547–586	Foreign Country or U.S. Possession	40	Enter the name of the foreign country or U.S. possession to which the withheld foreign tax (Amount Code 6) applies. Otherwise, enter blanks.
587–662	Blank	76	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. You may enter your routing and transit number (RTN) here. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–INT

Second TIN Notice (Optional)	Blank	Foreign Country or U.S. Possession	Blank	Special Data Entries	State Income Tax Withheld
544	545–546	547–586	587–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
735–746	747–748	749–750

(13) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–LTC

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Type of Payment Indicator	1	Enter the appropriate indicator from the following table; otherwise, enter blanks. Indicator — Usage 1 — Per diem 2 — Reimbursed amount
548–556	Social Security Number of Insured	9	**Required.** Enter the Social Security Number of the insured.
557–596	Name of Insured	40	**Required.** Enter the name of the insured.
597–636	Address of Insured	40	**Required.** Enter the address of the insured. Street address should include number, street, apartment or suite number (or PO Box if mail is not delivered to street address). Left-justify information and fill unused positions with blanks. This field **must not** contain any data other than payee's address.

For U.S. addresses, the payee city, state, and ZIP Code must be reported as a 40, 2, and 9-position field, respectively. **Filers must adhere to the correct format for the insured's city, state, and ZIP Code.**

For foreign addresses, filers may use the insured's city, state, and ZIP Code as a continuous 51-position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Country Indicator in position 247 must contain a "1" (one).

Field Position	Field Title	Length	Description and Remarks
637–676	City of Insured	40	**Required.** Enter the city, town, or post office. Left-justify information and fill the unused positions with blanks. Enter APO or FPO, if applicable. Do not enter state and ZIP Code information in this field.
677–678	State of Insured	2	**Required**. Enter the valid U.S. Postal Service state abbreviations for states or the appropriate postal identifier (AA, AE, or AP) described in Part A, Sec. 14.

(13) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–LTC (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
679–687	ZIP Code of Insured	9	**Required.** Enter the valid nine-digit ZIP Code assigned by the U.S. Postal Service. If only the first five-digits are known, left-justify information and fill the unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Country Indicator, located in position 247 of the "B" Record.
688	Status of Illness Indicator (Optional)	1	Enter the appropriate code from the table below to indicate the status of the illness of the insured; otherwise, enter blank. __Indicator__ — __Usage__ 1 — Chronically ill 2 — Terminally ill
689–696	Date Certified (Optional)	8	Enter the latest date of a doctor's certification of the status of the insured's illness. The format of the date is YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
697	Qualified Contract Indicator (Optional)	1	Enter a "1" (one) if benefits were from a qualified long-term care insurance contract; otherwise, enter a blank.
698–722	Blank	25	Enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled.
747–748	Blank	2	Enter blanks.
749–750	Blank	2	Enter blank or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–LTC

Blank	Type of Payment Indicator	SSN of Insured	Name of Insured	Address of Insured	City of Insured	State of Insured	ZIP Code of Insured
544–546	547	548–556	557–596	597–636	637–676	677–678	679–687

Status of Illness Indicator (Optional)	Date Certified (Optional)	Qualified Contract Indicator (Optional)	Blank	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
688	689–696	697	698–722	723–734	735–746	747–748	749–750

(14) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–MISC			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–546	Blank	2	Enter blanks.
547	Direct Sales Indicator **(See Note.)**	1	Enter a "1" (one) to indicate sales of $5,000 or more of consumer products to a person on a buy-sell, deposit-commission, or any other commission basis for resale anywhere other than in a permanent retail establishment. Otherwise, enter a blank.
Note: If reporting a direct sales indicator *only*, use Type of Return "A" in Field Position 27, and Amount Code 1 in Field Position 28 of the Payer "A" Record. All payment amount fields in the Payee "B" Record will contain zeros.			
548–662	Blank	115	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not used, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–MISC

Second TIN Notice (Optional)	Blank	Direct Sales Indicator	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld
544	545–546	547	548–662	663–722	723–734	735–746

Combined Federal/State Code	Blank or CR/LF
747–748	749–750

(15) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–OID			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–546	Blank	2	Enter blanks.
547–585	Description	39	**Required.** Enter the CUSIP number, if any. If there is no CUSIP number, enter the abbreviation for the stock exchange and issuer, the coupon rate, and year (**must be 4-digit year**) of maturity (e.g., NYSE XYZ 12/*2007*). Show the name of the issuer if other than the payer. If fewer than 39 characters are required, left-justify information and fill unused positions with blanks.
586–662	Blank	77	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–OID

Second TIN Notice (Optional)	Blank	Description	Blank	Special Data Entries	State Income Tax Withheld
544	545–546	547–585	586–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
735–746	747–748	749–750

(16) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–PATR

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" (two) to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, enter a blank.
545–662	Blank	118	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for 1099–PATR

Second TIN Notice (Optional)	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
544	545–662	663–722	723–734	735–746	747–748	749–750

(17) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–Q

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Trustee to Trustee Transfer Indicator	1	**Required.** Enter a "1" (one) if reporting a trustee to trustee transfer; otherwise, enter a blank.

(17) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–Q (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
548	Type of Tuition Payment	1	**Required.** Enter the appropriate code from the table below to indicate the type of tuition payment; otherwise, enter a blank. Indicator — Usage 1 — Private program payment 2 — State program payment 3 — Coverdell ESA contribution
549	Designated Beneficiary	1	**Required.** Enter a "1" (one) if the recipient is not the designated beneficiary; otherwise, enter a blank.
550–662	Blank	113	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–Q

Blank	Trustee to Trustee Transfer Indicator	Type of Tuition Payment	Designated Beneficiary	Blank	Special Data Entries	Blank	Blank or CR/LF
544–546	547	548	549	550–662	663–722	723–748	749–750

(18) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–R			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Blank	1	Enter a blank.
545–546	Distribution Code (For a detailed explanation of distribution codes, see the *2007 Instructions for Forms 1099–R and 5498.*) **See chart at the end of this record layout for a diagram of valid combinations of Distribution Codes.**	2	**Required.** Enter at least one distribution code from the table below. More than one code may apply. If only one code is necessary, it must be entered in position 545 and position 546 will be blank. When using Code P for an IRA distribution under section 408(d)(4) of the Internal Revenue Code, the filer may also enter Code 1, 2, 4, or J if applicable. Only three numeric combinations are acceptable, Codes 8 and 1, 8 and 2, and 8 and 4, on one return. These three combinations can be used only if both codes apply to the distribution being reported. If more than one numeric code is applicable to different parts of a distribution, report two separate "B" Records. Distribution Codes 3, 5, 6, 9, E, F, N, Q, R, S and T cannot be used with any other codes. Distribution Code G may be used with Distribution Code 4 only if applicable.

(18) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–R (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**

Code	Category
1	*Early distribution, no known exception (in most cases, under age 59½)
2	*Early distribution, exception applies (Under age 59½)
3	*Disability
4	*Death
5	*Prohibited transaction
6	Section 1035 exchange (a tax-free exchange of life insurance, annuity, or endowment contracts)
7	*Normal distribution
8	*Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in *2007*
9	Cost of current life insurance protection (premiums paid by a trustee or custodian for current insurance protection)
A	May be eligible for 10-year tax option
B	Designated Roth account distribution
D	*Excess contributions plus earnings/excess deferrals taxable in *2005*
E	Excess annual additions under section 415/certain excess amounts under section 403(b) plans
F	Charitable gift annuity
G	Direct rollover and rollover contribution
J	Early distribution from a Roth IRA. (This code may be used with Code 8 or P.)
L	Loans treated as deemed distributions under section 72(p)
N	Recharacterized IRA contribution made for *2007*
P	*Excess contributions plus earnings/excess deferrals taxable in *2006*
Q	Qualified distribution from a Roth IRA. (Distribution from a Roth IRA when the 5-year holding period has been met, and the recipient has reached 59½, has died, or is disabled.)
R	Recharacterized IRA contribution made for *2006* **(See Note.)**
S	*Early distribution from a SIMPLE IRA in first 2 years, no known exception
T	Roth IRA distribution, exception applies because participant has reached 59½ , died or is disabled, but it is unknown if the 5-year period has been met.

(18) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–R (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
***If reporting a traditional IRA, SEP, or SIMPLE distribution or a Roth conversion, use the IRA/SEP/SIMPLE Indicator of "1" (one) in position 548 of the Payee "B" Record.**			
Note: The trustee of the first IRA must report the recharacterization as a distribution on Form 1099–R (and the original contribution and its character on Form 5498).			
547	Taxable Amount Not Determined Indicator	1	Enter "1" (one) only if the taxable amount of the payment entered for Payment Amount Field 1 (Gross distribution) of the "B" Record cannot be computed; otherwise, enter blank. (If Taxable Amount Not Determined Indicator is used, enter "0's" [zeros] in Payment Amount Field 2 of the Payee "B" Record.) Please make every effort to compute the taxable amount.
548	IRA/SEP/SIMPLE Indicator	1	Enter "1" (one) for a traditional IRA, SEP, or SIMPLE distribution or Roth conversion; otherwise, enter a blank. **(See Note.)** If the IRA/SEP/SIMPLE Indicator is used, enter the amount of the Roth conversion or distribution in Payment Amount Field A of the Payee "B" Record. **Do not use the indicator for a distribution from a Roth or for an IRA recharacterization.**
Note: For Form 1099–R, generally, report the Roth conversion or total amount distributed from a traditional IRA, SEP, or SIMPLE in Payment Amount Field A (traditional IRA/SEP/SIMPLE distribution or Roth conversion), as well as Payment Amount Field 1 (Gross Distribution) of the "B" Record. Refer to the *2007 Instructions for Forms 1099–R and 5498* for exceptions (Box 2a instructions).			
549	Total Distribution Indicator **(See Note.)**	1	Enter a "1" (one) only if the payment shown for Distribution Amount Code 1 is a total distribution that closed out the account; otherwise, enter a blank.
Note: A total distribution is one or more distributions within one tax year in which the entire balance of the account is distributed. Any distribution that does not meet this definition is not a total distribution.			
550–551	Percentage of Total Distribution	2	Use this field when reporting a total distribution to more than one person, such as when a participant is deceased and a payer distributes to two or more beneficiaries. Therefore, if the percentage is 100, leave this field blank. If the percentage is a fraction, round off to the nearest whole number (for example, 10.4 percent will be 10 percent; 10.5 percent will be 11 percent). Enter the percentage received by the person whose TIN is included in positions 12–20 of the "B" Record. This field must be right-justified, and unused positions must be zero-filled. If not applicable, enter blanks. Filers are not required to enter this information for any IRA distribution or for direct rollovers.
552–555	*First Year of Designated Roth Contribution*	*4*	*Enter the first year a designated Roth contribution was made in YYYY format. If the date is unavailable, enter blanks.*
556–662	*Blank*	*107*	*Enter blanks.*
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filer. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.

(18) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–R (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

FORM 1099–R DISTRIBUTION CODE CHART 2007

POSITION 546

POSITION 545	blank	1	2	3	4	5	6	7	8	9	A	B	D	E	F	G	J	L	N	P	Q	R	S	T
1	X								X			X	X					X		X				
2	X								X			X	X							X				
3	X																							
4	X								X		X	X	X			X		X		X				
5	X																							
6	X																							
7	X										X													
8	X	X	X		X							X					X							
9	X																							
A					X			X																
B	X	X	X		X				X							X		X		X				
D	X	X	X		X																			
E	X																							
F	X																							
G	X				X							X												
J	X								X											X				
L	X	X			X							X												
N	X																							
P	X	X	X		X							X					X							
Q	X																							
R	X																							
S	X																							
T	X																							

X – Denotes valid combinations

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–R

Blank	Distribution Code	Taxable Amount Not Determined Indicator	IRA/SEP/SIMPLE Indicator	Total Distribution Indicator	Percentage of Total Distribution
544	545–546	547	548	549	550–551

First Year of Designated Roth Contribution	*Blank*	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/State Code	Blank or CR/LF
552–555	*556–662*	663–722	723–734	735–746	747–748	749–750

(19) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–S

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	Property or Services Indicator	1	**Required.** Enter "1" (one) if the transferor received or will receive property (other than cash and consideration treated as cash in computing gross proceeds) or services as part of the consideration for the property transferred. Otherwise, enter a blank.
548–555	Date of Closing	8	**Required.** Enter the closing date in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.**
556–594	Address or Legal Description	39	**Required.** Enter the address of the property transferred (including city, state, and ZIP Code). If the address does not sufficiently identify the property, also enter a legal description, such as section, lot, and block. For timber royalties, enter "TIMBER." If fewer than 39 positions are required, left-justify information and fill unused positions with blanks.
595–662	Blank	68	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.

(19) Payee "B" Record — Record Layout Positions 544–750 for Form 1099-S (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
747–748	Blank	2	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099-S

Blank	Property or Services Indicator	Date of Closing	Address or Legal Description	Blank	Special Data Entries
544–546	547	548–555	556–594	595–662	663–722

State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
723–734	735–746	747–748	749–750

(20) Payee "B" Record — Record Layout Positions 544–750 for Form 1099-SA			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544	Blank	1	Enter a blank.
545	Distribution Code	1	**Required.** Enter the applicable code to indicate the type of payment. Code — Category 1 — Normal distribution 2 — Excess contribution 3 — Disability 4 — Death distribution other than code 6 (This includes distributions to a spouse, nonspouse, or estate beneficiary in the year of death and to an estate after the year of death.) 5 — Prohibited transaction 6 — Death distribution **after year of death** to a nonspouse beneficiary. (Do not use for distribution to an estate.)
546	Blank	1	Enter a blank.
547	Medicare Advantage MSA Indicator	1	Enter "1" (one) if distributions are from a Medicare Advantage MSA. Otherwise, enter a blank.
548	HSA Indicator	1	Enter "1" (one) if distributions are from a HSA. Otherwise, enter a blank.
549	Archer MSA Indicator	1	Enter "1" (one) if distributions are from an Archer MSA. Otherwise, enter a blank.

(20) Payee "B" Record — Record Layout Positions 544–750 for Form 1099–SA (Continued)

Field Position	Field Title	Length	Description and Remarks
550–662	Blank	113	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Blank	2	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 1099–SA

Blank	Distribution Code	Blank	Medicare Advantage MSA Indicator	HSA Indicator	Archer MSA Indicator	Blank	Special Data Entries
544	545	546	547	548	549	550–662	663–722

State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
723–734	735–746	747–748	749–750

(21) Payee "B" Record — Record Layout Positions 544–750 for Form 5498

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	Enter blanks.
547	**IRA** Indicator (Individual Retirement Account)	1	**Required, if applicable.** Enter "1" (one) if reporting a Rollover (Amount Code 2), Recharacterized Contribution (Amount Code 4) or Fair Market Value (Amount Code 5) for an IRA. Otherwise, enter a blank.

(21) Payee "B" Record — Record Layout Positions 544–750 for Form 5498 (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
548	**SEP** Indicator (Simplified Employee Pension)	1	**Required, if applicable.** Enter "1" (one) if reporting Rollover (Amount Code 2), Recharacterized Contribution (Amount Code 4) or Fair Market Value (Amount Code 5) for a SEP. Otherwise, enter a blank.
549	**SIMPLE** Indicator (Savings Incentive Match Plan for Employees)	1	**Required, if applicable.** Enter "1" (one) if reporting a Rollover (Amount Code 2), Recharacterized Contribution (Amount Code 4) or Fair Market Value (Amount Code 5) for a SIMPLE. Otherwise, enter a blank.
550	**Roth IRA** Indicator	1	**Required, if applicable.** Enter "1" (one) if reporting a Rollover (Amount Code 2), Recharacterized Contribution (Amount Code 4) or Fair Market Value (Amount Code 5) for a Roth IRA. Otherwise, enter a blank.
551	RMD Indicator	1	**Required.** Enter "1" (one) if reporting RMD for 2007. Otherwise, enter a blank.
552–662	Blank	111	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks. **(See Note.)**

Note: For delayed contributions for U.S. Armed Forces, use the Special Data Entry field to report the year for which the contribution was made, the amount of the contribution and one of the indicators as outlined in the current Instructions for Forms 1099–R and 5498.

723–746	Blank	24	Enter blanks.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 12, Table 1. For those payers or states not participating in this program, enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 5498

Blank	IRA Indicator	SEP Indicator	SIMPLE Indicator	Roth IRA Indicator	RMD Indicator
544–546	547	548	549	550	551

Blank	Special Data Entries	Blank	Combined Federal/State Code	Blank or CR/LF
552–662	663–722	723–746	747–748	749–750

(22) Payee "B" Record — Record Layout Positions 544–750 for Form 5498–ESA			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–662	Blank	119	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 5498–ESA

Blank	Special Data Entries	Blank	Blank or CR/LF
544–662	663–722	723–748	749–750

(23) Payee "B" Record — Record Layout Positions 544–750 for Form 5498–SA			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–546	Blank	3	Enter blanks.
547	Medicare Advantage MSA Indicator	1	Enter "1" (one) for Medicare Advantage MSA. Otherwise, enter a blank.
548	HSA Indicator	1	Enter "1" (one) for HSA. Otherwise, enter a blank.
549	Archer MSA Indicator	1	Enter "1" (one) for Archer MSA. Otherwise, enter a blank.
550–662	Blank	113	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–748	Blank	26	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form 5498–SA

Blank	Medicare Advantage MSA Indicator	HSA Indicator	Archer MSA Indicator	Blank	Special Data Entries	Blank	Blank or CR/LF
544–546	547	548	549	550–662	663–722	723–748	749–750

(24) Payee "B" Record — Record Layout Positions 544–750 for Form W–2G			
Field Position	**Field Title**	**Length**	**Description and Remarks**
544–546	Blank	3	Enter blanks.
547	Type of Wager Code	1	**Required.** Enter the applicable type of wager code from the table below. Code / Category 1 Horse race track (or off-track betting of a horse track nature) 2 Dog race track (or off-track betting of a dog track nature) 3 Jai-alai 4 State-conducted lottery 5 Keno 6 Bingo 7 Slot machines 8 Any other type of gambling winnings
548–555	Date Won	8	**Required.** Enter the date of the winning transaction in the format YYYYMMDD (e.g., January 5, 2007, would be 20070105). **Do not enter hyphens or slashes.** This is not the date the money was paid, if paid after the date of the race (or game).
556–570	Transaction	15	**Required.** For state-conducted lotteries, enter the ticket or other identifying number. For keno, bingo, and slot machines, enter the ticket or card number (and color, if applicable), machine serial number, or any other information that will help identify the winning transaction. For all others, enter blanks.
571–575	Race	5	If applicable, enter the race (or game) relating to the winning ticket; otherwise, enter blanks.
576–580	Cashier	5	If applicable, enter the initials or number of the cashier making the winning payment; otherwise, enter blanks.
581–585	Window	5	If applicable, enter the window number or location of the person paying the winning payment; otherwise, enter blanks.
586–600	First ID	15	For other than state lotteries, enter the first identification number of the person receiving the winnings; otherwise, enter blanks.
601–615	Second ID	15	For other than state lotteries, enter the second identification number of the person receiving the winnings; otherwise, enter blanks.
616–662	Blank	47	Enter blanks.
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, enter blanks.
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries field.

(24) Payee "B" Record — Record Layout Positions 544–750 for Form W–2G (Continued)

Field Position	Field Title	Length	Description and Remarks
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right-justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries field.
747–748	Blank	2	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Payee "B" Record — Record Layout Positions 544–750 for Form W–2G

Blank	Type of Wager Code	Date Won	Transaction	Race	Cashier	Window	First ID
544–546	547	548–555	556–570	571–575	576–580	581–585	586–600

Second ID	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
601–615	616–662	663–722	723–734	735–746	747–748	749–750

Sec. 7. End of Payer "C" Record — General Field Descriptions and Record Layout

.01 The "C" Record consists of the total number of payees and the totals of the payment amount fields filed for each payer and/or particular type of return. The "C" Record must follow the last "B" Record for each type of return for each payer.

.02 For each "A" Record and group of "B" Records on the file, there must be a corresponding "C" Record.

.03 The End of Payer "C" Record is a fixed length of 750 positions. The control fields are each 18 positions in length.

Record Name: End of Payer "C" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "C".
2–9	Number of Payees	8	**Required.** Enter the total number of "B" Records covered by the preceding "A" Record. Right-justify information and fill unused positions with zeros.
10–15	Blank	6	Enter blanks.

Record Name: End of Payer "C" Record (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
16–33	Control Total 1	18	**Required.** Accumulate totals of any payment amount fields in the "B" Records into the appropriate control total fields of the "C" Record. **Control totals must be right-justified and unused control total fields zero-filled.** All control total fields are 18 positions in length. Each payment amount must contain U.S. dollars and cents. The right-most two positions represent cents in the payment amount fields. **Do not enter dollar signs, commas, decimal points, or negative payments, except those items that reflect a loss on Form 1099–B or 1099–Q.** Positive and negative amounts are indicated by placing a "+" (plus) or "-" (minus) sign in the left-most position of the payment amount field.
34–51	Control Total 2	18	
52–69	Control Total 3	18	
70–87	Control Total 4	18	
88–105	Control Total 5	18	
106–123	Control Total 6	18	
124–141	Control Total 7	18	
142–159	Control Total 8	18	
160–177	Control Total 9	18	
178–195	Control Total A	18	
196–213	Control Total B	18	
214–231	Control Total C	18	
232–249	Control Total D	18	
250–267	Control Total E	18	
268–499	Blank	232	Enter blanks.
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–748	Blank	241	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

End of Payer "C" Record — Record Layout

Record Type	Number of Payees	Blank	Control Total 1	Control Total 2	Control Total 3	Control Total 4	Control Total 5	Control Total 6
1	2–9	10–15	16–33	34–51	52–69	70–87	88–105	106–123

Control Total 7	Control Total 8	Control Total 9	Control Total A	Control Total B	Control Total C	Control Total D	Control Total E	Blank
124–141	142–159	160–177	178–195	196–213	214–231	232–249	250–267	268–499

Record Sequence Number	Blank	Blank or CR/LF
500–507	508–748	749–750

Sec. 8. State Totals "K" Record — General Field Descriptions and Record Layout

.01 The State Totals "K" Record is a summary for a given payer and a given state in the Combined Federal/State Filing Program, used **only** when state-reporting approval has been granted.

.02 The "K" Record will contain the total number of payees and the total of the payment amount fields filed by a given payer for a given state. The "K" Record(s) must be written after the "C" Record for the related "A" Record. A file format diagram is located at the end of Part D.

.03 The "K" Record is a fixed length of 750 positions. The control total fields are each 18 positions in length.

.04 In developing the "K" Record, for example, if a payer used Amount Codes 1, 3, and 6 in the "A" Record, the totals from the "B" Records coded for this state would appear in Control Totals 1, 3, and 6 of the "K" Record.

.05 There must be a separate "K" Record for **each state** being reported.

.06 Refer to Part A, Sec. 12, for the requirements and conditions that **must** be met to file via this program.

Record Name: State Totals "K" Record — Record Layout Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "K".
2–9	Number of Payees	8	**Required.** Enter the total number of "B" Records being coded for this state. Right-justify information and fill unused positions with zeros.
10–15	Blank	6	Enter blanks.
16–33	Control Total 1	18	**Required.** Accumulate totals of any payment amount fields in the "B" Records for each state being reported into the appropriate control total fields of the appropriate "K" Record. Each payment amount must contain U.S. dollars and cents. The right-most two positions represent cents in the payment amount fields. **Control totals must be right-justified and unused control total fields zero-filled.** All control total fields are 18 positions in length.
34–51	Control Total 2	18	
52–69	Control Total 3	18	
70–87	Control Total 4	18	
88–105	Control Total 5	18	
106–123	Control Total 6	18	
124–141	Control Total 7	18	
142–159	Control Total 8	18	
160–177	Control Total 9	18	
178–195	Control Total A	18	
196–213	Control Total B	18	
214–231	Control Total C	18	
232–249	Control Total D	18	
250–267	Control Total E	18	
268–499	Blank	232	Enter blanks.

Record Name: State Totals "K" Record — Record Layout Forms 1099–DIV, 1099–G, 1099–INT, 1099–MISC, 1099–OID, 1099–PATR, 1099–R, and 5498 (Continued)			
Field Position	**Field Title**	**Length**	**Description and Remarks**
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–706	Blank	199	Enter blanks.
707–724	State Income Tax Withheld Total	18	State income tax withheld total is for the convenience of the filers. Aggregate totals of the state income tax withheld field in the Payee "B" Records; otherwise, enter blanks.
725–742	Local Income Tax Withheld Total	18	Local income tax withheld total is for the convenience of the filer. Aggregate totals of the local income tax withheld field in the Payee "B" Records; otherwise, enter blanks.
743–746	Blank	4	Enter blanks.
747–748	Combined Federal/State Code	2	**Required.** Enter the code assigned to the state which is to receive the information. (Refer to Part A, Sec. 12, Table l.)
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

State Totals "K" Record — Record Layout Forms 1099–DIV, 1099–G, 1099–INT, 1099–MISC, 1099–OID, 1099–PATR, 1099–R, and 5498

Record Type	Number of Payees	Blank	Control Total 1	Control Total 2	Control Total 3	Control Total 4	Control Total 5	Control Total 6
1	2–9	10–15	16–33	34–51	52–69	70–87	88–105	106–123

Control Total 7	Control Total 8	Control Total 9	Control Total A	Control Total B	Control Total C	Control Total D	Control Total E	Blank
124–141	142–159	160–177	178–195	196–213	214–231	232–249	250–267	268–499

Record Sequence Number	Blank	State Income Tax Withheld Total	Local Income Tax Withheld Total	Blank	Combined Federal/State Code	Blank or CR/LF
500–507	508–706	707–724	725–742	743–746	747–748	749–750

Sec. 9. End of Transmission "F" Record — General Field Descriptions and Record Layout

.01 The End of Transmission "F" Record is a summary of the number of payers/payees in the entire file.

.02 The "F" Record is a fixed record length of 750 positions.

.03 This record must be written after the last "C" Record (or last "K" Record, when applicable) of the entire file.

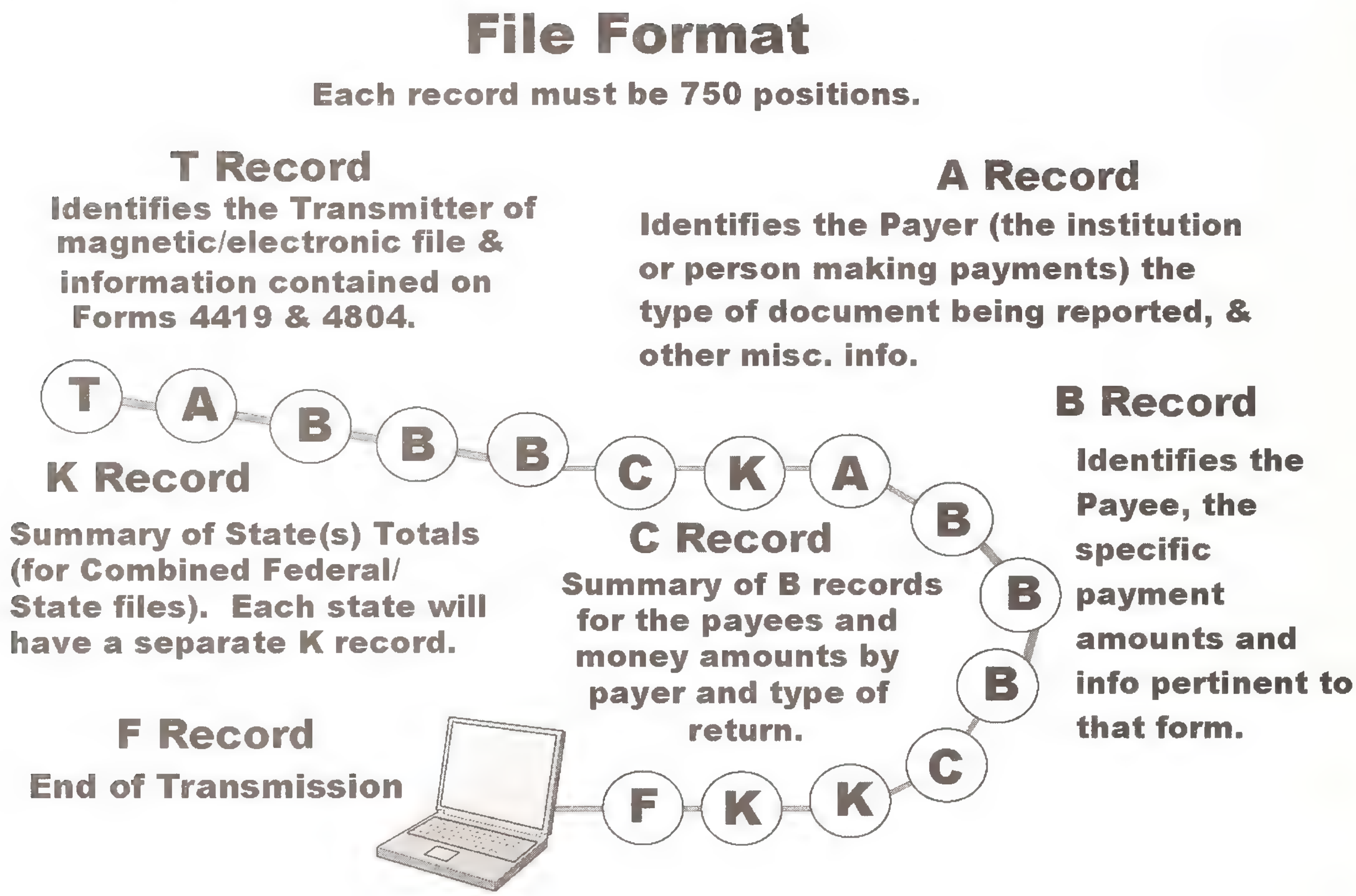
Record Name: End of Transmission "F" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "F."
2–9	Number of "A" Records	8	Enter the total number of Payer "A" Records in the entire file (right-justify and zero-fill) or enter all zeros.
10–30	Zero	21	Enter zeros.
31–49	Blank	19	Enter blanks.
50–57	Total Number of Payees	8	Enter the total number of Payee "B" Records reported in the file. Right-justify information and fill unused positions with zeros. If you have entered this total in the "T" Record, you may leave this field blank.
58–499	Blank	442	Enter blanks.
500–507	Record Sequence Number	8	**Required.** Enter the number of the record as it appears within your file. The record sequence number for the "T" record will always be "1" (one), since it is the first record on your file and you can have only one "T" record in a file. Each record, thereafter, must be incremented by one in ascending numerical sequence, i.e., 2, 3, 4, etc. Right-justify numbers with leading zeros in the field. For example, the "T" record sequence number would appear as "00000001" in the field, the first "A" record would be "00000002", the first "B" record, "00000003", the second "B" record, "00000004" and so on until you reach the final record of the file, the "F" record.
508–748	Blank	241	Enter blanks.
749–750	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

End of Transmission "F" Record — Record Layout

Record Type	Number of "A" Records	Zero	Blank	Total Number of Payees	Blank	Record Sequence Number	Blank	Blank or CR/LF
1	2–9	10–30	31–49	50–57	58–499	500–507	508–748	749–750

Sec. 10. File Layout Diagram



Part E. Extensions of Time and Waivers

Sec. 1. General — Extensions

.01 An extension of time to file may be requested for Forms 1098, 1099, 5498, 5498–SA, 5498–ESA, W–2G, W–2 series, 8027 and 1042–S.

.02 A paper Form 8809, Application for Extension of Time To File Information Returns, should be submitted to IRS/ECC-MTB at the address listed in .09 of this section. This form may be used to request an extension of time to file information returns submitted on paper, electronically or magnetically to the IRS. Use a separate Form 8809 for each method of filing information returns you intend to use, i.e., electronically, magnetically or paper.

.03 *The fill-in Form 8809 may be completed online via the FIRE System. (See Part B, Sec. 8, for instructions on connecting to the FIRE System.) At the Main Menu, click "Extension of Time Request" and then click "Fill-in Extension Form". This option is only used to request an automatic 30-day extension. If you are requesting an additional extension, you must submit a paper Form 8809. Requests for an additional extension of time to file information returns are not automatically granted. Requests for additional time are granted only in cases of extreme hardship or catastrophic event. The IRS will only send a letter of explanation approving or denying your additional extension request. (Refer to .12 of this Section.)*

.04 To be considered, an extension request must be postmarked, transmitted or completed online by the due date of the returns; otherwise, the request will be denied. (See Part A, Sec. 8, for due dates.) If requesting an extension of time to file several types of forms, use one Form 8809; however, Form 8809 or file must be submitted no later than the earliest due date. For example, if requesting an extension of time to file both Forms 1099–INT and 5498, submit Form 8809 on or before February 28, 2008.

.05 As soon as it is apparent that a 30-day extension of time to file is needed, an extension request should be submitted. It may take up to 30 days for IRS/ECC-MTB to respond to an extension request. IRS/ECC-MTB does not begin processing extension requests until January. ***Extensions completed online via the FIRE System receive instant results.***

.06 Under certain circumstances, a request for an extension of time may be denied. When a denial letter is received, any additional or necessary information may be resubmitted within 20 days.

.07 Requesting an extension of time for multiple payers (50 or less) may be done by mailing Form 8809 and attaching a list of the payer names and associated TINs (EIN or SSN) or by completing the fill-in form online. Each payer must be included in the listing or

completed online to ensure an extension is recorded for all payers. Form 8809 may be computer-generated or photocopied. Be sure to use the most recently updated version and include all the pertinent information.

.08 Requests for an extension of time to file for more than 50 payers are **required** to be submitted electronically, magnetically or completed online. IRS encourages requests for 10 to 50 payers to be filed electronically, magnetically or completed online. (See Sec. 3, for the record layout.) Tape cartridge is the only acceptable magnetic media. (Refer to Part C.)

.09 All requests for an extension of time filed on Form 8809 or tape cartridge should be sent using the following address:

IRS-Enterprise Computing Center — Martinsburg
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

Note: Due to the large volume of mail received by IRS/ECC-MTB and the time factor involved in processing Extension of Time (EOT) requests, it is imperative that the attention line be present on all envelopes or packages containing Form 8809.

.10 Requests for extensions of time to file postmarked by the United States Postal Service on or before the due date of the returns, and delivered by United States mail to IRS/ECC-MTB after the due date, are treated as timely under the "timely mailing as timely filing" rule. A similar rule applies to designated private delivery services (PDSs). See Part A, Sec. 8, for more information on PDSs. For requests delivered by a designated PDS, but through a non-designated service, the actual date of receipt by IRS/ECC-MTB will be used as the filing date.

.11 Transmitters requesting an extension of time by an electronic or magnetic file will receive an approval or denial letter, accompanied by a list of payers covered under that approval/denial.

.12 If an additional extension of time is needed, a second Form 8809 or file must be filed by the initial extended due date. Check line 7 on the form to indicate that an additional extension is being requested. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic event. **If requesting a second 30-day extension of time, submit the information return files as soon as prepared. Do not wait for IRS/ECC-MTB's response to your second extension request.**

.13 If an extension request is approved, the approval notification should be kept on file. **DO NOT** send the approval notification or copy of the approval notification to IRS/ECC-MTB with the tape cartridge file or to the service center where the paper returns are filed.

.14 Request an extension for only one tax year.

.15 A signature is not required when requesting a 30-day extension. If a second 30-day extension is requested, the Form 8809 **MUST** be signed. Failure to properly complete and sign Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of Form 8809.

.16 Form 8809 may be obtained by calling **1–800–TAX–FORM (1–800–829–3676)**. The form is also available on the **IRS website at www.irs.gov**. A copy of Form 8809 is also provided in the back of Publication 1220.

Sec. 2. Specifications for Electronic Filing or Tape Cartridge Extensions of Time

.01 The specifications in Sec. 3 include the required 200-byte record layout for extensions of time to file requests submitted electronically or magnetically. Also included are the instructions for the information that is to be entered in the record. **Filers are advised to read this section in its entirety to ensure proper filing.**

.02 If a filer does not have an IRS/ECC-MTB assigned Transmitter Control Code (TCC), Form 4419, Application for Filing Information Returns Electronically, **must** be submitted to obtain a TCC. This number **must** be used to submit an extension request electronically/magnetically. (See Part A, Sec. 6.)

.03 For extension requests filed on tape cartridges, the transmitter must mail the completed Form 8809, Application for Extension of Time To File Information Returns, in the same package as the corresponding media or fax it to 304–264–5602. For extension requests filed electronically, the transmitter must fax Form 8809 the same day the transmission is made. Due to security concerns, extension requests may **not** be emailed with the Form 8809 as an attachment.

.04 Transmitters submitting an extension of time electronically or magnetically should not submit a list of payer names and TINs with Form 8809 since this information is included on the electronic or magnetic file. However, Line 6 of Form 8809 must be completed with the total number of records included on the electronic or tape cartridge file. The fill-in Form 8809 cannot be used in lieu of the paper Form 8809 for electronic or tape cartridge files.

.05 Do not submit tax year 2007 extension requests filed on tape cartridges before *January 1, 2008*, or electronically before *January 3, 2008*.

.06 Each tape cartridge **must** have an external media label containing the following information:

(a) Transmitter name
(b) Transmitter Control Code (TCC)
(c) Tax year

(d) The words "Extension of Time"

(e) Record count

.07 Electronic filing, and tape cartridge specifications for extensions are the same as the specifications for filing of information returns. (See Part B or C for specific technical information.)

Sec. 3. Record Layout — Extension of Time

.01 Positions 6 through 188 of the following record should contain information about the **payer** for whom the extension of time to file is being requested. Do not enter transmitter information in these fields. **Only one TCC may be present in a file.**

Record Layout for Extension of Time

Field Position	Field Title	Length	Description and Remarks
1–5	Transmitter Control Code	5	**Required**. Enter the five-character alpha/numeric Transmitter Control Code (TCC) issued by IRS. **Only one TCC per file is acceptable.**
6–14	Payer TIN	9	**Required**. Must be the valid nine-digit EIN/SSN assigned to the payer. **Do not enter blanks, hyphens or alpha characters.** All zeros, ones, twos, etc., will have the effect of an incorrect TIN. For foreign entities that are not required to have a TIN, this field may be blank; however, the Foreign Entity Indicator, position 187, **must** be set to "X".
15–54	Payer Name	40	**Required**. Enter the name of the payer whose TIN appears in positions 6–14. Left-justify information and fill unused positions with blanks.
55–94	Second Payer Name	40	If additional space is needed, this field may be used to continue name line information (e.g., c/o First National Bank); otherwise; enter blanks.
95–134	Payer Address	40	**Required**. Enter the payer's address. Street address should include number, street, apartment or suite number (or PO Box if mail is not delivered to a street address).
135–174	Payer City	40	**Required**. Enter payer city, town, or post office.
175–176	Payer State	2	**Required**. Enter the payer valid U.S. Postal Service state abbreviation. (Refer to Part A, Sec. 14.)
177–185	Payer ZIP Code	9	**Required**. Enter payer ZIP Code. If using a five-digit ZIP Code, left-justify information and fill unused positions with blanks.
186	Document Indicator **(See Note.)**	1	**Required**. Enter the appropriate document code that indicates the form for which you are requesting an extension of time. **Code** — **Document** 1 — W–2 2 — 1098, 1098–C, 1098–E, 1098–T, 1099–A, 1099–B, 1099–C, 1099–CAP, 1099–DIV, 1099–G, 1099–H, 1099–INT, 1099–LTC, 1099–MISC, 1099–OID, 1099–PATR, 1099–Q, 1099–R, 1099–S, 1099–SA, or W–2G 3 — 5498 4 — 1042–S 5 — REMIC Documents (1099–INT or 1099–OID) 6 — 5498–SA 7 — 5498–ESA

Field Position	Field Title	Length	Description and Remarks
Note: Do not enter any other values in this field. Submit a separate record for each document. For example, if you are requesting an extension for Form 1099–INT and Form 5498 for the same payee, submit one record with "2" coded in this field and another record with "3" coded in this field. If you are requesting an extension for Form 1099–DIV and Form 1099–MISC for the same payer, submit one record with "2" coded in this field.			
187	Foreign Entity Indicator	1	Enter "X" if the payer is a foreign entity.
188	Recipient Request Indicator	1	Enter "X" if the extension request is to furnish statements to the recipients of the information return.
Note: A separate file is required for this type of extension request. A file must either contain all blanks or all X's in this field.			
189–198	Blank	10	Enter blanks.
199–200	Blank	2	Enter blanks or carriage return/line feed (CR/LF) characters.

Record Layout for Extension of Time (Continued)

Extension of Time Record Layout

Transmitter Control Code	Payer TIN	Payer Name	Second Payer Name	Payer Address	Payer City	Payer State
1–5	6–14	15–54	55–94	95–134	135–174	175–176

Payer ZIP Code	Document Indicator	Foreign Entity Indicator	Recipient Request Indicator	Blank	Blank or CR/LF
177–185	186	187	188	189–198	199–200

Sec. 4. Extension of Time for Recipient Copies of Information Returns

.01 Request an **extension of time to furnish the statements to recipients** of Forms 1098, 1099 series, 5498 series, W–2G, W–2 series, and 1042–S by submitting a letter to IRS/ECC-MTB at the address listed in Part E, Sec. 1.09. The letter should contain the following information:

- **(a)** Payer name
- **(b)** TIN
- **(c)** Address
- **(d)** Type of return
- **(e)** Specify that the extension request is to provide statements to recipients
- **(f)** Reason for delay
- **(g)** Signature of payer or duly authorized person

.02 Requests for an extension of time to furnish statements to recipients of Forms 1098, 1099 series, 5498 series, W–2G, W–2 series, and 1042–S are not automatically approved; however, if approved, generally an extension will allow a **MAXIMUM** of 30 additional days from the due date. The request must be postmarked by the date on which the statements are due to the recipients.

.03 Generally, only the payer may sign the letter requesting the extension for recipient copies. A transmitter must have a contractual agreement with the filers to submit extension requests on their behalf. This should be stated in your letter of request for recipient copy extensions.

.04 Requests for a **recipient** extension of time to file for more than 50 payers are **required** to be submitted electronically or magnetically. IRS encourages requests for 10 to 50 payers to be filed electronically or magnetically. (See Sec. 3, for the record layout.) The request may be filed electronically or on tape cartridges.

.05 The fill-in Form 8809 extension option cannot be used to request an extension to furnish statements to recipients.

Sec. 5. Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically

.01 If a payer is required to file on magnetic media but fails to do so (or fails to file electronically in lieu of magnetic media filing) and does not have an approved waiver on record, the payer will be subject to a penalty of $50 per return in excess of 250. (For penalty information, refer to the Penalty Section of the *2007 General Instructions for Forms 1099, 1098, 5498, and W–2G.*)

.02 If payers are required to file original or corrected returns on magnetic media, but such filing would create an undue hardship, they may request a waiver from these filing requirements by submitting Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically, to IRS/ECC-MTB. Form 8508 can be obtained on the IRS website at *www.irs.gov* or by calling toll-free 1–800–829–3676.

.03 Even though a payer may submit as many as 249 corrections on paper, IRS encourages electronic or magnetic filing of corrections. Once the 250 threshold has been met, filers are required to submit any returns of 250 or more electronically or magnetically. However, if a waiver for original documents is approved, any corrections for the same type of returns will be covered under that waiver.

.04 Generally, only the payer may sign Form 8508. A transmitter may sign if given power of attorney; however, a letter signed by the payer stating this fact must be attached to Form 8508.

.05 A transmitter must submit a separate Form 8508 for each payer. Do not submit a list of payers.

.06 All information requested on Form 8508 must be provided to IRS for the request to be processed.

.07 The waiver, if approved, will provide exemption from the electronic/magnetic media filing requirement for the current tax year only. Payers may not apply for a waiver for more than one tax year at a time; application must be made each year a waiver is necessary.

.08 Form 8508 may be photocopied or computer-generated as long as it contains all the information requested on the original form.

.09 Filers are encouraged to submit Form 8508 to IRS/ECC-MTB at least 45 days before the due date of the returns. IRS/ECC-MTB does not process waiver requests until January. Waiver requests received prior to January are processed on a first come, first serve basis.

.10 All requests for a waiver should be sent using the following address:

IRS-Enterprise Computing Center — Martinsburg
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

.11 File Form 8508 for the W–2 series of forms with IRS/ECC-MTB, not SSA.

.12 Waivers are evaluated on a case-by-case basis and are approved or denied based on criteria set forth in the regulations under section 6011(e) of the Internal Revenue Code. The transmitter must allow a minimum of 30 days for IRS/ECC-MTB to respond to a waiver request.

.13 If a waiver request is approved, keep the approval letter on file. **DO NOT** send a copy of the approved waiver to the service center where the paper returns are filed.

.14 An approved waiver only applies to the requirement for filing information returns electronically/magnetically. The payer must still timely file information returns on the official IRS paper forms or an acceptable substitute form with the appropriate service center.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 2007–52

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SECTION 1. WHAT IS THE PURPOSE OF THIS REVENUE PROCEDURE?

This revenue procedure sets forth procedures for issuing determination letters and rulings on the exempt status of organizations under §§ 501 and 521 of the Internal Revenue Code other than those subject to Rev. Proc. 2007–6, 2007–1 I.R.B. 189 (relating to pension, profit-sharing, stock bonus, annuity, and employee stock ownership plans). Generally, the Service issues these determination letters and rulings in response to applications for recognition of exemption from Federal income tax. These procedures also apply to revocation or modification of determination letters or rulings. This revenue procedure also provides guidance on the exhaustion of administrative remedies for purposes of declaratory judgment under § 7428 of the Code.

Description of terms used in this revenue procedure

.01 For purposes of this revenue procedure –

(1) the term "Service" means the Internal Revenue Service.

(2) the term "application" means the appropriate form or letter that an organization must file or submit to the Service for recognition of exemption from Federal income tax under the applicable section of the Internal Revenue Code. See section 3 for information on specific forms.

(3) the term "EO Determinations" means the office of the Service that is primarily responsible for processing initial applications for tax-exempt status. It includes the main EO Determinations office located in Cincinnati, Ohio, and other field offices that are under the direction and control of the Manager, EO Determinations.

(4) the term "EO Technical" means the office of the Service that is primarily responsible for issuing letter rulings to taxpayers on exempt organization matters, and for providing technical advice or technical assistance to other offices of the Service on exempt organization matters. The EO Technical office is located in Washington, DC.

(5) the term "Appeals Office" means any office under the direction and control of the Chief, Appeals. The purpose of the Appeals Office is to resolve tax controversies, without litigation, on a fair and impartial basis. The Appeals Office is independent of EO Determinations and EO Technical.

(6) the term "determination letter" means a written statement issued by EO Determinations or an Appeals Office in response to an application for recognition of exemption from Federal income tax under §§ 501 and 521. This includes a written statement issued by EO Determinations or an Appeals Office on the basis of advice secured from EO Technical pursuant to the procedures prescribed herein and in Rev. Proc. 2007–5, 2007–1 I.R.B. 161.

(7) the term "ruling" means a written statement issued by EO Technical in response to an application for recognition of exemption from Federal income tax under §§ 501 and 521.

Updated annually

.02 This revenue procedure is updated annually, but may be modified or amplified during the year.

SECTION 2. NATURE OF CHANGES AND RELATED REVENUE PROCEDURES

Rev. Proc. 90–27 is superseded and the processing of applications is now centralized

.01 This revenue procedure updates Rev. Proc. 90–27, 1990–1 C.B. 514, which is hereby superseded.

(1) The responsibility for processing applications is now centralized in the EO Determinations office in Cincinnati, Ohio. Key district offices no longer exist.

(2) Although applications are generally processed in the Cincinnati office, some applications may be processed in other EO Determinations offices or referred to EO Technical.

Related revenue procedures

.02 This revenue procedure supplements Rev. Proc. 76–34, 1976–2 C.B. 656, with respect to the effects of § 7428 of the Code on the classification of organizations under §§ 509(a) and 4942(j)(3). Rev. Proc. 80–27, 1980–1 C.B. 677, sets forth procedures under which exemption may be recognized on a group basis for subordinate organizations affiliated with and under the general supervision and control of a central organization. Rev. Proc. 72–5, 1972–1 C.B. 709, provides information for religious and apostolic organizations seeking recognition of exemption under § 501(d). General procedures for requests for a determination letter or ruling are provided in Rev. Proc. 2007–4, 2007–1 I.R.B. 118. User fees for requests for a determination letter or ruling are set forth in Rev. Proc. 2007–8, 2007–1 I.R.B. 230.

SECTION 3. WHAT ARE THE PROCEDURES FOR REQUESTING RECOGNITION OF EXEMPT STATUS?

In general

.01 An organization seeking recognition of exempt status under § 501 or § 521 is required to submit the appropriate application. In the case of a numbered application form, the current version of the form must be submitted. A central organization that has previously received recognition of its own exemption can request a group exemption letter by submitting a letter application with Form 8718, *User Fee for Exempt Organization Determination Letter Request. See* Rev. Proc. 80–27.

User fee

.02 An application must be submitted with the correct user fee, as set forth in Rev. Proc. 2007–8.

Form 1023 application

.03 An organization seeking recognition of exemption under § 501(c)(3) and §§ 501(e), (f), (k), (n) or (q) must submit a completed Form 1023. In the case of an organization that provides credit counseling services, see section 501(q) of the Code.

Form 1024 application

.04 An organization seeking recognition of exemption under §§ 501(c)(2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19) or (25) must submit a completed Form 1024 with Form 8718. In the case of an organization that provides credit counseling services and seeks recognition of exemption under section 501(c)(4), see section 501(q) of the Code.

Letter application

.05 An organization seeking recognition of exemption under §§ 501(c)(11), (14), (16), (18), (21), (22), (23), (26), (27) or (28) or under § 501(d) must submit a letter application with Form 8718.

Form 1028 application

.06 An organization seeking recognition of exemption under § 521 must submit a completed Form 1028 with Form 8718.

Form 8871 notice for political organizations

.07 A political party, a campaign committee for a candidate for federal, state or local office, and a political action committee are all political organizations subject to tax under § 527. To be tax-exempt, a political organization may be required to notify the Service that it is to be treated

as a § 527 organization by electronically filing Form 8871, *Political Organization Notice of Section 527 Status*. For details, go to the IRS website at *www.irs.gov/polorgs*.

Requirements for a substantially completed application

.08 A substantially completed application, including a letter application, is one that:

(1) is signed by an authorized individual.

(2) includes an Employer Identification Number (EIN).

(3) includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years). If the organization has not yet commenced operations, or has not completed one accounting period, a substantially completed application generally includes a proposed budget for two full accounting periods and a current statement of assets and liabilities.

(4) includes a detailed narrative statement of proposed activities, including each of the fundraising activities of a § 501(c)(3) organization, and a narrative description of anticipated receipts and contemplated expenditures.

(5) includes a copy of the organizing or enabling document that is signed by a principal officer or is accompanied by a written declaration signed by an authorized individual certifying that the document is a complete and accurate copy of the original or otherwise meets the requirements of a "conformed copy" as outlined in Rev. Proc. 68–14, 1968–1 C.B. 768.

(6) if the organizing or enabling document is in the form of articles of incorporation, includes evidence that it was filed with and approved by an appropriate state official (*e.g.*, stamped "Filed" and dated by the Secretary of State). Alternatively, a copy of the articles of incorporation may be submitted if accompanied by a written declaration signed by an authorized individual that the copy is a complete and accurate copy of the original copy that was filed with and approved by the state. If a copy is submitted, the written declaration must include the date the articles were filed with the state.

(7) if the organization has adopted by-laws, includes a current copy. The by-laws need not be signed if submitted as an attachment to the application for recognition of exemption. Otherwise, the by-laws must be verified as current by an authorized individual.

(8) is accompanied by the correct user fee and Form 8718, when applicable.

Terrorist organizations not eligible to apply for recognition of exemption

.09 An organization that is identified or designated as a terrorist organization within the meaning of section 501(p)(2) of the Code is not eligible to apply for recognition of exemption.

SECTION 4. WHAT ARE THE STANDARDS FOR ISSUING A DETERMINATION LETTER OR RULING ON EXEMPT STATUS?

Exempt status must be established in application and supporting documents

.01 A favorable determination letter or ruling will be issued to an organization only if its application and supporting documents establish that it meets the particular requirements of the section under which exemption from Federal income tax is claimed.

Determination letter or ruling based solely on administrative record

.02 A determination letter or ruling on exempt status is issued based solely upon the facts and representations contained in the administrative record.

(1) The applicant is responsible for the accuracy of any factual representations contained in the application.

(2) Any oral representation of additional facts or modification of facts as represented or alleged in the application must be reduced to writing over the signature of an authorized individual.

(3) The failure to disclose a material fact or misrepresentation of a material fact on the application may adversely affect the reliance that would otherwise be obtained through issuance by the Service of a favorable determination letter or ruling.

Exempt status may be recognized in advance of actual operations

.03 Exempt status may be recognized in advance of the organization's operations if the proposed activities are described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed.

(1) A mere restatement of exempt purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement.

(2) The organization must fully describe all of the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures.

(3) Where the organization cannot demonstrate to the satisfaction of the Service that it qualifies for exemption pursuant to the section of the Internal Revenue Code under which exemption is claimed, the Service will generally issue a proposed adverse determination letter or ruling. *See also* section 7.

No letter if exempt status issue in litigation or under consideration within the Service

.04 A determination letter or ruling on exempt status will not ordinarily be issued if an issue involving the organization's exempt status under § 501 or § 521 is pending in litigation, is under consideration within the Service, or if issuance of a determination letter or ruling is not in the interest of sound tax administration. If the Service declines to issue a determination or ruling to an organization seeking exempt status under § 501(c)(3), the organization may pursue a declaratory judgment under § 7428 provided that it has exhausted its administrative remedies.

Incomplete application

.05 If an application does not contain all of the items set out in section 3.08, the Service may return it to the applicant for completion.

(1) In lieu of returning an incomplete application, the Service may retain the application and request additional information needed for a substantially completed application.

(2) In the case of an application or a group exemption request under § 501(c)(3) that is returned incomplete, the 270-day period referred to in § 7428(b)(2) will not be considered as starting until the date a substantially completed Form 1023 or group exemption request is refiled with or remailed to the Service. If the application or group exemption request is mailed to the Service and a postmark is not evident, the 270-day period will start to run on the date the Service actually receives the substantially completed Form 1023 or group exemption request. The same rules apply for purposes of the notice requirement of § 508.

(3) Generally, the user fee will not be refunded if an incomplete application is filed. *See* Rev. Proc. 2007–8, section 10.

Even if application is complete, additional information may be required

.06 Even though an application is substantially complete, the Service may request additional information before issuing a determination letter or ruling.

(1) If the application involves an issue where contrary authorities exist, an applicant's failure to disclose and distinguish contrary authorities may result in requests for additional information, which could delay final action on the application.

(2) In the case of an application under § 501(c)(3), the period of time beginning on the date the Service requests additional information until the date the information is submitted to the Service will not be counted for purposes of the 270-day period referred to in § 7428(b)(2).

Expedited handling

.07 Applications are normally processed in the order of receipt by the Service. However, expedited handling of an application may be approved where a request is made in writing and contains a compelling reason for processing the application ahead of others. Upon approval of a request for expedited handling, an application will be considered out of its normal order.

This does not mean the application will be immediately approved or denied. Circumstances generally warranting expedited processing include:

(1) A grant to the applicant is pending and the failure to secure the grant may have an adverse impact on the organization's ability to continue to operate.

(2) The purpose of the newly created organization is to provide disaster relief to victims of emergencies such as flood and hurricane.

(3) There have been undue delays in issuing a determination letter or ruling caused by a Service error.

SECTION 5. WHAT OFFICES ISSUE AN EXEMPT STATUS DETERMINATION LETTER OR RULING?

EO Determinations issues a determination letter in most cases

.01 Under the general procedures outlined in Rev. Proc. 2007–4, EO Determinations is authorized to issue determination letters on applications for exempt status under §§ 501 and 521.

Certain applications referred to EO Technical

.02 EO Determinations will refer to EO Technical those applications that present issues which are not specifically covered by statute or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. In addition, EO Determinations will refer those applications that have been specifically reserved by revenue procedure or by other official Service instructions for handling by EO Technical for purposes of establishing uniformity or centralized control of designated categories of cases. EO Technical will notify the applicant organization upon receipt of a referred application, and will consider each such application and issue a ruling directly to the organization.

Technical advice may be requested in certain cases

.03 If at any time during the course of consideration of an exemption application by EO Determinations the organization believes that its case involves an issue on which there is no published precedent, or there has been non-uniformity in the Service's handling of similar cases, the organization may request that EO Determinations either refer the application to EO Technical or seek technical advice from EO Technical. *See* Rev. Proc. 2007–5, section 4.04.

Technical advice must be requested in certain cases

.04 If EO Determinations proposes to recognize the exemption of an organization to which EO Technical had issued a previous contrary ruling or technical advice, EO Determinations must seek technical advice from EO Technical before issuing a determination letter. This does not apply where EO Technical issued an adverse ruling and the organization subsequently made changes to its purposes, activities, or operations to remove the basis for which exempt status was denied.

SECTION 6. WITHDRAWAL OF AN APPLICATION

Application may be withdrawn prior to issuance of a determination letter or ruling

.01 An application may be withdrawn upon the written request of an authorized individual at any time prior to the issuance of a determination letter or ruling. Therefore, an application may not be withdrawn after the issuance of a proposed adverse determination letter or ruling.

(1) When an application is withdrawn, the Service will retain the application and all supporting documents. The Service may consider the information submitted in connection with the withdrawn request in a subsequent examination of the organization.

(2) Generally, the user fee will not be refunded if an application is withdrawn. *See* Rev. Proc. 2007–8, section 10.

§ 7428 implications of withdrawal of application under § 501(c)(3)

.02 The Service will not consider the withdrawal of an application under § 501(c)(3) as either a failure to make a determination within the meaning of § 7428(a)(2) or as an exhaustion of administrative remedies within the meaning of § 7428(b)(2).

SECTION 7. WHAT ARE THE PROCEDURES WHEN EXEMPT STATUS IS DENIED?

Proposed adverse determination letter or ruling

.01 If EO Determinations or EO Technical reaches the conclusion that the organization does not satisfy the requirements for exempt status pursuant to the section of the Internal Revenue Code under which exemption is claimed, the Service will generally issue a proposed adverse determination letter or ruling, which will:

(1) Include a detailed discussion of the Service's rationale for the denial of tax-exempt status.

(2) Advise the organization of its opportunity to appeal or protest the decision and request a conference.

Appeal of a proposed adverse determination letter issued by EO Determinations

.02 A proposed adverse determination letter issued by EO Determinations will advise the organization of its opportunity to appeal the determination by requesting Appeals Office consideration. To do this, the organization must submit a statement of the facts, law and arguments in support of its position within 30 days from the date of the adverse determination letter. The organization must also state whether it wishes an Appeals Office conference. Any determination letter issued on the basis of technical advice from EO Technical may not be appealed to the Appeals Office on issues that were the subject of the technical advice.

Protest of a proposed adverse ruling issued by EO Technical

.03 A proposed adverse ruling issued by EO Technical will advise the organization of its opportunity to file a protest statement within 30 days and to request a conference. If a conference is requested, the conference procedures outlined in Rev. Proc. 2007–4, section 12, are applicable.

Final adverse determination letter or ruling where no appeal or protest is submitted

.04 If an organization does not submit a timely appeal of a proposed adverse determination letter issued by EO Determinations, or a timely protest of a proposed adverse ruling issued by EO Technical, a final adverse determination letter or ruling will be issued to the organization. The final adverse letter or ruling will provide information about the filing of tax returns and the disclosure of the proposed and final adverse letters or rulings.

How EO Determinations handles an appeal of a proposed adverse determination letter

.05 If an organization submits an appeal of the proposed adverse determination letter, EO Determinations will first review the appeal, and if it determines that the organization qualifies for tax-exempt status issue a favorable exempt status determination letter. If EO Determinations maintains its adverse position after reviewing the appeal, it will forward the appeal and the exemption application case file to the Appeals Office.

Consideration by the Appeals Office

.06 The Appeals Office will consider the organization's appeal. If the Appeals Office agrees with the proposed adverse determination, it will either issue a final adverse determination or, if a conference was requested, contact the organization to schedule a conference. At the end of the conference process, which may involve the submission of additional information, the Appeals Office will either issue a final adverse determination letter or a favorable determination letter. If the Appeals Office believes that an exemption or private foundation status issue is not covered by published precedent or that there is non-uniformity, the Appeals Office must request technical advice from EO Technical in accordance with Rev. Proc. 2007–5, section 4.04.

If a protest of a proposed adverse ruling is submitted to EO Technical

.07 If an organization submits a protest of a proposed adverse exempt status ruling, EO Technical will review the protest statement. If the protest convinces EO Technical that the organization qualifies for tax-exempt status, a favorable ruling will be issued. If EO Technical maintains its adverse position after reviewing the protest, it will either issue a final adverse ruling or, if a conference was requested, contact the organization to schedule a conference. At the end of the conference process, which may involve the submission of additional information, EO Technical will either issue a final adverse ruling or a favorable exempt status ruling.

An appeal or protest may be withdrawn

.08 An organization may withdraw its appeal or protest before the Service issues a final adverse determination letter or ruling. Upon receipt of the withdrawal request, the Service will complete the processing of the case in the same manner as if no appeal or protest was received.

Appeal or protest and conference rights not applicable in certain situations

.09 The opportunity to appeal or protest a proposed adverse determination letter or ruling and the conference rights described above are not applicable to matters where delay would be prejudicial to the interests of the Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

SECTION 8. DISCLOSURE OF APPLICATIONS AND DETERMINATION LETTERS AND RULINGS

§§ 6104 and 6110 of the Code provide rules for the disclosure of applications, including supporting documents, and determination letters and rulings.

Disclosure of applications, supporting documents, and favorable determination letters or rulings

.01 The applications, any supporting documents, and the favorable determination letter or ruling issued are available for public inspection under § 6104(a)(1) of the Code. However, there are certain limited disclosure exceptions for a trade secret, patent, process, style of work, or apparatus if the Service determines that the disclosure of the information would adversely affect the organization.

(1) The Service is required to make the applications, supporting documents, and favorable determination letters or rulings available upon request. The public can request this information by submitting Form 4506–A, *Request for Public Inspection or Copy of Exempt or Political Organization IRS Form.*

(2) The exempt organization is required to make its exemption application, supporting documents, and determination letter or ruling available for public inspection without charge. For more information about the exempt organization's disclosure obligations, *see* Publication 557, *Tax-Exempt Status for Your Organization.*

Disclosure of adverse determination letters or rulings

.02 The Service is required to make adverse determination letters and rulings available for public inspection under § 6110 of the Code. Upon issuance of the final adverse determination letter or ruling to an organization, both the proposed adverse determination letter or ruling and the final adverse determination letter or ruling will be released under § 6110.

(1) These documents are made available to the public after the deletion of names, addresses, and any other information that might identify the taxpayer. See § 6110(c) for other specific disclosure exemptions.

(2) The final adverse determination letter or ruling will enclose Notice 437, *Notice of Intention to Disclose*, and redacted copies of the final and proposed adverse determination letters or rulings. Notice 437 provides instructions if the organization disagrees with the deletions proposed by the Service.

Disclosure to State officials when the Service refuses to recognize exemption under § 501(c)(3)

.03 The Service may notify the appropriate State officials of a refusal to recognize an organization as tax-exempt under § 501(c)(3). *See* § 6104(c) of the Code. The notice to the State officials may include a copy of a proposed or final adverse determination letter or ruling the Service issued to the organization. In addition, upon request by the appropriate State official, the Service may make available for inspection and copying the exemption application and other information relating to the Service's determination on exempt status.

Disclosure to State officials of information about § 501(c)(3) applicants

.04 The Service may disclose to State officials the name, address, and identification number of any organization that has applied for recognition of exemption under § 501(c)(3).

SECTION 9. REVIEW OF DETERMINATION LETTERS BY EO TECHNICAL

Determination letters may be reviewed by EO Technical to assure uniformity

.01 Determination letters issued by EO Determinations may be reviewed by EO Technical, or the Office of the Associate Chief Counsel (Passthroughs and Special Industries) (for cases under § 521), to assure uniform application of the statutes or regulations, or rulings, court opinions, or decisions published in the Internal Revenue Bulletin.

Procedures for cases where EO Technical takes exception to a determination letter

.02 If EO Technical takes exception to a determination letter issued by EO Determinations, the manager of EO Determinations will be advised. If EO Determinations notifies the organization of the exception taken, and the organization disagrees with the exception, the file will be returned to EO Technical. The referral to EO Technical will be treated as a request for technical advice and the procedures in Rev. Proc. 2007–5 will be followed.

SECTION 10. DECLARATORY JUDGMENT PROVISIONS OF § 7428

Actual controversy involving certain issues

.01 Generally, a declaratory judgment proceeding under § 7428 of the Code can be filed in the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia with respect to an actual controversy involving a determination by the Service or a failure of the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under § 501(c)(3) (charitable, educational, etc.); § 170(c)(2) (deductibility of contributions); § 509(a) (private foundation status); or § 4942(j)(3) (operating foundation status).

Exhaustion of administrative remedies

.02 Before filing a declaratory judgment action, an organization must exhaust its administrative remedies by taking, in a timely manner, all reasonable steps to secure a determination from the Service. These include:

(1) the filing of a substantially completed application Form 1023 or group exemption request under § 501(c)(3) pursuant to section 3.08 of this Revenue Procedure or the request for a determination of foundation status pursuant to Rev. Proc. 76–34;

(2) in appropriate cases, requesting relief pursuant to § 301.9100–1 of the Procedure and Administration Regulations regarding the extension of time for making an election or application for relief from tax (*see* Rev. Proc. 92–85, 1992–2 C.B. 490);

(3) the timely submission of all additional information requested by the Service to perfect an exemption application or request for determination of private foundation status; and

(4) exhaustion of all administrative appeals available within the Service pursuant to section 7.

Not earlier than 270 days after seeking determination

.03 An organization will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

(1) the completion of the steps in section 10.02, and the sending by the Service by certified or registered mail of a final determination letter or ruling; or

(2) the expiration of the 270-day period described in § 7428(b)(2) in a case where the Service has not issued a final determination letter or ruling and the organization has taken, in a timely manner, all reasonable steps to secure a determination letter or ruling.

Service must have reasonable time to act on an appeal or protest

.04 The steps described in section 10.02 will not be considered completed until the Service has had a reasonable time to act upon an appeal or protest as the case may be.

Final determination to which § 7428 applies

.05 A final determination to which § 7428 of the Code applies is a determination letter or ruling, sent by certified or registered mail, which holds that the organization is not described in § 501(c)(3) or § 170(c)(2), is a public charity described in a part of § 509 or § 170(b)(1)(A) other than the part under which the organization requested classification, is not a private foundation as defined in § 4942(j)(3), or is a private foundation and not a public charity described in a part of § 509 or § 170(b)(1)(A).

SECTION 11. EFFECT OF DETERMINATION LETTER OR RULING RECOGNIZING EXEMPTION

Effective date of exemption

.01 A determination letter or ruling recognizing exemption is usually effective as of the date of formation of an organization if its purposes and activities prior to the date of the determination letter or ruling were consistent with the requirements for exemption. However, special rules under § 508(a) of the Code may apply to an organization applying for exemption under § 501(c)(3), and special rules under § 505(c) may apply to an organization applying for exemption under §§ 501(c)(9), (17), or (20).

(1) If the Service requires the organization to alter its activities or make substantive amendments to its enabling instrument, the exemption will be effective as of the date specified in a determination letter or ruling.

(2) If the Service requires the organization to make a nonsubstantive amendment, exemption will ordinarily be recognized as of the date of formation. Examples of nonsubstantive amendments include correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities of the organization prior to the determination letter or ruling are consistent with the requirements for exemption.

Reliance on determination letter or ruling

.02 A determination letter or ruling recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization. Also, a determination letter or ruling may not be relied upon if it was based on any inaccurate material factual representations. *See* section 12.01.

SECTION 12. REVOCATION OR MODIFICATION OF DETERMINATION LETTER OR RULING RECOGNIZING EXEMPTION

A determination letter or ruling recognizing exemption may be revoked or modified by (1) a notice to the taxpayer to whom the determination letter or ruling was issued, (2) enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuance of temporary or final regulations, or (5) the issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin.

Revocation or modification of a determination letter or ruling may be retroactive

.01 The revocation or modification of a determination letter or ruling recognizing exemption may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which § 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. In certain cases an organization may seek relief from retroactive revocation or modification of a determination letter or ruling under § 7805(b). Requests for § 7805(b) relief are subject to the procedures set forth in Rev. Proc. 2007–5.

(1) Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change.

(2) In the case where a determination letter or ruling is issued in error or is no longer in accord with the Service's position and § 7805(b) relief is granted (*see* sections 13 and 14 of Rev. Proc. 2007–4), ordinarily, the revocation or modification will be effective not earlier than the date when the Service modifies or revokes the original determination letter or ruling.

Appeal and conference procedures in the case of revocation or modification of exempt status letter

.02 In the case of a revocation or modification of a determination letter or ruling, the appeal and conference procedures are generally the same as set out in section 7 of these procedures, including the right of the organization to request that EO Determinations or the Appeals Office seek technical advice from EO Technical. However, appeal and conference rights are not applicable to matters where delay would be prejudicial to the interests of the Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

(1) If the case involves an exempt status issue on which EO Technical had issued a previous contrary ruling or technical advice, EO Determinations generally must seek technical advice from EO Technical.

(2) EO Determinations does not have to seek technical advice if the prior ruling or technical advice has been revoked by subsequent contrary published precedent or if the proposed revocation involves a subordinate unit of an organization that holds a group exemption letter issued by EO Technical, the EO Technical ruling or technical advice was issued under the Internal Revenue Code of 1939 or prior revenue acts, or if the ruling was issued in response to Form 4653, *Notification Concerning Foundation Status*.

SECTION 13. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 90–27 is superseded.

SECTION 14. EFFECTIVE DATE

This revenue procedure is effective July 23, 2007.

SECTION 15. PAPERWORK REDUCTION ACT

The collection of information for a letter application under section 3.05 of this revenue procedure has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2080. All other collections of information under this revenue procedure have been approved under separate OMB control numbers.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of this information is required if an organization wants to be recognized as tax-exempt by the Service. We need the information to determine whether the organization meets the legal requirements for tax-exempt status. In addition, this information will be used to help the Service delete certain information from the text of an adverse determination letter or ruling before it is made available for public inspection, as required by § 6110.

The time needed to complete and file a letter application will vary depending on individual circumstances. The estimated average time is 10 hours.

Books and records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. The rules governing the confidentiality of letter applications are covered in § 6104.

DRAFTING INFORMATION

The principal author of this revenue procedure is Wayne Hardesty of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the TE/GE Customer Service office at (877) 829–5500 (a toll-free call).

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, §§ 61, 451, 471, 481; 1.451–1.)

Rev. Proc. 2007–53

SECTION 1. PURPOSE

In general, the Internal Revenue Service will follow *Westpac Pacific Food v. Commissioner*, 451 F.3d 970 (9th Cir. 2006), with respect to taxpayers that adopt the Advance Trade Discount Method of accounting described in section 4 of this revenue procedure. Accordingly, this revenue procedure permits accrual method taxpayers described in section 3 of this revenue procedure to account for advance trade discounts under the Advance Trade Discount Method. This revenue procedure also provides procedures to obtain the automatic consent of the Commissioner to change to the Advance Trade Discount Method.

SECTION 2. BACKGROUND

In *Westpac*, an accrual method taxpayer received payments, referred to as "advance trade discounts," upon entering into contracts with sellers of merchandise. Under the contracts, the taxpayer was required to purchase a minimum amount of merchandise during the term of a contract and was obligated to refund a *pro rata* portion of the cash payment to the extent the purchase commitment was not satisfied. In *Westpac*, the court held that the advance trade discount was not recognized as gross income under § 61 by the taxpayer when received.

SECTION 3. SCOPE

This revenue procedure applies to an accrual method taxpayer required to use an inventory method of accounting and maintaining inventories, as provided for in § 471 of the Internal Revenue Code and the regulations thereunder, that receives advance trade discounts (as defined in section 4.03 of this revenue procedure).

SECTION 4. ADVANCE TRADE DISCOUNT METHOD

.01 *In General.* A taxpayer within the scope of this revenue procedure is permitted to use the Advance Trade Discount Method of accounting. Under the Advance Trade Discount Method, an advance trade discount (as defined in section 4.03 of this revenue procedure) is not recognized as gross income under § 61 upon receipt. The advance trade discount generally is taken into account for federal income tax purposes in the amount of, in the manner of, and for the taxable year in which the taxpayer accounts for the discount in its applicable financial statements (as defined in section 4.06 of this revenue procedure). Thus, if a taxpayer reports an advance trade discount related to specific items of inventory in its applicable financial statements as a reduction to the cost of that inventory, the taxpayer must treat the discount as a trade or other discount under § 471 and reduce only the cost of the inventory to which the discount relates in the amount of, in the same manner as, and for the taxable year in which it reduces the cost of that inventory in its applicable financial statements. The taxpayer may not, for example, unwind the allocation made in its applicable financial statements and instead allocate the discount using the simplified resale method. Alternatively, if a taxpayer allocates an advance trade discount in its applicable financial statements exclusively to cost of goods sold, the taxpayer must treat the discount as a reduction to the cost of goods sold in the amount of and for the taxable year in which the discount is allocated to cost of goods sold in its applicable financial statements. However, a taxpayer must reduce the cost of the inventory to which the discount relates as the taxpayer purchases the inventory if that treatment results in the advance trade discount being recognized for federal income tax purposes earlier than when the taxpayer accounts for the discount in its applicable financial statements.

.02 *Taxpayers Without Applicable Financial Statements.* To use the Advance Trade Discount Method, a taxpayer within the scope of this revenue procedure that does not have applicable financial statements (as defined in section 4.06 of this revenue procedure) must reduce only the cost of the specific items of inventory to which the discount relates as the taxpayer purchases the inventory.

.03 *Advance Trade Discounts.* A payment received by a taxpayer is an advance trade discount if:

(1) The payment is received from a seller of merchandise in exchange for a commitment by the taxpayer to purchase a minimum amount of merchandise from the seller within a period that does not exceed 5 years from the date of the agreement;

(2) Except as provided for in section 4.04 of this revenue procedure, the payment is intended to be a discount to the price of the merchandise to be purchased;

(3) The taxpayer is obligated, either in writing or because of industry custom, to repay an allocable portion, or all, of the payment if the underlying purchase commitment is not met; and

(4) The taxpayer does not treat the payment as a payment for services in its applicable financial statements (as defined in section 4.06 of this revenue procedure), if any.

.04 *Exclusive Supplier Agreements and Shelving Allowances.* Solely for purposes of the Advance Trade Discount Method, amounts allocable to exclusive supplier agreements and shelving (slotting) allowances included as part of a purchase commitment described in section 4.03(1) of this revenue procedure will be treated as advance trade discounts if the taxpayer is obligated to repay an allocable portion of those amounts if the underlying purchase commitment is not met and the requirements in sections 4.03(3) and (4) of this revenue procedure are satisfied.

.05 *Allocable Payments.* Except as provided for in section 4.04 of this revenue procedure, a taxpayer that receives a payment that is partially attributable to an advance trade discount described in section 4.03 of this revenue procedure may use the Advance Trade Discount Method only with respect to the portion of the payment that is allocable to the advance trade discount based on objective criteria. For example, if the taxpayer receives a payment, part of which is for an advance trade discount and for part of which the taxpayer is obligated to perform or provide cooperative advertising services, the taxpayer may use the Advance Trade Discount Method only for the portion of the payment that the taxpayer is able to demonstrate, based on objective criteria, is attributable to the advance trade discount.

.06 *Applicable Financial Statement.* The taxpayer's applicable financial statement is the taxpayer's financial statement listed in paragraphs (1) through (3) of this section 4.06 that has the highest priority (including within paragraph (2)). A taxpayer that does not have a financial statement described in paragraphs (1) through (3) of this section 4.06 does not have an applicable financial statement for purposes of this revenue procedure. The financial statements are, in descending priority —

(1) a financial statement required to be filed with the Securities and Exchange Commission ("SEC") (the 10-K or the Annual Statement to Shareholders);

(2) a certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign corporation, by the report of a similarly qualified independent professional), that is used for –

(a) credit purposes,

(b) reporting to shareholders, or

(c) any other substantial non-tax purpose; or

(3) a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agency (other than the SEC or the Internal Revenue Service).

SECTION 5. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE ADVANCE TRADE DISCOUNT METHOD

A taxpayer's use of the Advance Trade Discount Method provided for in section 4 of this revenue procedure on a federal income tax return filed before July 2, 2007, will not be raised as an issue by the Service. Moreover, if a taxpayer's use of the Advance Trade Discount Method on a federal income tax return filed before July 2,

2007, is an issue under consideration in examination, appeals, or before the Tax Court, the issue will not be further pursued by the Service.

SECTION 6. CHANGE IN ACCOUNTING METHOD

.01 *In General.* A change in a taxpayer's method of accounting for advance trade discounts to the Advance Trade Discount Method provided for in section 4 of this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Therefore, a taxpayer within the scope of this revenue procedure that wants to change to the Advance Trade Discount Method for taxable years ending on or after July 2, 2007, must obtain the consent of the Commissioner under § 446(e) and § 1.446–1(e)(3).

.02 *Automatic Change.* A taxpayer within the scope of this revenue procedure that wants to change to the Advance Trade Discount Method must obtain the consent of the Commissioner by following the automatic change in method of accounting procedures in Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432) (or its successor), with the following additional modifications: (1) the scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to make the change for its first taxable year ending on or after July 2, 2007; and (2) for purposes of section 6.02(4)(a) of Rev. Proc. 2002–9, the taxpayer must include on Line 1a of the Form 3115 the designated automatic accounting method change number "111."

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include in the APPENDIX the automatic change provided in this revenue procedure.

DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Grant D. Anderson at (202) 622–4930 (not a toll-free number).

Part IV. Items of General Interest

Elimination of Schedule P of Form 5500 Series

Announcement 2007–63

On July 21, 2006, the Department of Labor announced rules mandating electronic filings of the Form 5500, *Annual Return/Report of Employee Benefit Plan*, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), 71 **Fed. Reg.** 41359 (Jul. 21, 2006). To reduce administrative burdens of employers, plans, their administrators and trustees and custodians, and in anticipation of the transition to a wholly electronic filing environment under the ERISA Filing Acceptance System (EFAST), the Service has determined that the continued use of a Schedule P, *Annual Return of Fiduciary of Employee Benefit Trust*, in connection with the filing of a plan's Form 5500 is no longer necessary for the efficient administration of the Internal Revenue laws.

Pursuant to the authority contained in § 6033(a) of the Internal Revenue Code, the Schedule P, which may be completed by a trustee of an employee benefit trust as the annual return of that trust, is being eliminated. The elimination of Schedule P is effective for the 2005 and later plan years for Form 5500–EZ filers. For all other Form 5500 series filers, the elimination of Schedule P is effective for the 2006 and later plan years.

For plan years in which the Schedule P is eliminated, the Service will treat the plan's filing of a return from the applicable Form 5500 series as if the filing constitutes a return of the plan's employee benefit trust for purposes of § 6501(g)(2). Thus, the Service will not assess income taxes with respect to an employee benefit trust later than the limitations periods specified in section 6501 for the assessment of tax related to the Form 5500 filed by the plan to which the trust relates. Notwithstanding the preceding sentence, in any case in which the plan has been a party to an abusive tax avoidance transaction, as defined in section 4.13(2) of Rev. Proc. 2006–27, 2006–1 C.B. 945, or any successor thereto, the period during which the Service may assess income taxes with respect to the plan's employee benefit trust shall expire 6 years from the date the plan administrator or employer files a complete and accurate Form 5500 series (including all related schedules).

Drafting Information

The principal authors of this announcement are Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division, and William D. Gibbs and Dana A. Barry of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this announcement, please contact the Employee Plans taxpayer assistance answering service at 1–877–829–5500 (a toll-free call) between the hours of 8:30 a.m. and 4:30 p.m. Eastern time Monday through Friday or Mr. Rubin at *RetirementPlanQuestions@irs.gov*. Mr. Gibbs and Ms. Barry can be reached at 202–622–6060 (not a toll-free call).

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–65

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on July 23, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Eagle A C, Inc.
Louisville, KY

Annie T. Smith Mercy Fund
Randolf, VT

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 83.—Property Transferred in Connection With Performance of Services

26 CFR 1.83–3: Meaning and use of certain terms.

Post-grant restrictions. This ruling sets forth the tax consequences under section 83 of the Code when restrictions are imposed on substantially vested stock causing that stock to become substantially nonvested. The ruling holds that if the imposition of such restrictions occurs in the absence of an exchange of stock, the substantially nonvested stock is not subject to section 83. However, if the substantially vested stock is exchanged for substantially nonvested stock, the substantially nonvested stock is subject to section 83.

Rev. Rul. 2007–49

ISSUES

1) Is there a transfer of substantially nonvested stock subject to § 83 of the Internal Revenue Code where restrictions imposed on substantially vested stock cause the substantially vested stock to become substantially nonvested?

2) Is there a transfer of substantially nonvested stock subject to § 83 where a service provider exchanges substantially vested stock for substantially nonvested stock in a reorganization described in § 368(a)?

3) Is there a transfer of substantially nonvested stock subject to § 83 where a service provider exchanges substantially vested stock for substantially nonvested stock in a taxable stock acquisition?

FACTS

Investors form Corporation X in 2004, by contributing $1,000 each to Corporation X in exchange for 100 shares of Corporation X stock. In exchange for Individual A's agreement to perform services for Corporation X, Corporation X issues 100 shares of its stock to A. The fair market value of the Corporation X stock on that date is $10 per share. The shares of Corporation X stock transferred to A are "substantially vested" within the meaning of § 1.83–3(b) of the Income Tax Regulations.

For the 2004 taxable year, the amount included in A's income under § 83(a) is $1,000 (the fair market value of the stock ($10 x 100 shares) less the amount paid ($0)). A's basis in the stock is $1,000.

Situation 1. In connection with its plan to start a new business venture, Corporation X seeks financing from Investor M on July 9, 2007. Investor M agrees to invest funds in Corporation X in exchange for a specified number of shares and the further requirement that A agree to subject A's shares to a restriction that will cause the stock to be "substantially nonvested" within the meaning of § 1.83–3(b). Under this restriction, if the employment of A with Corporation X terminates before July 9, 2009, A must sell the shares to Corporation X in exchange for the lesser of $150 per share (the fair market value of Corporation X stock on July 9, 2007) or the fair market value at the time of forfeiture. In addition, the shares are nontransferable before that date. A remains employed with Corporation X, and on July 9, 2009, the fair market value of Corporation X stock is $250 per share.

Situation 2. Corporation Y, a corporation unrelated to Corporation X, agrees to acquire all of the stock of Corporation X. Accordingly, on August 9, 2010, Corporation Y causes Corporation Z (a newly formed wholly-owned subsidiary of Corporation Y) to merge into Corporation X in a transaction that qualifies as a reorganization described in § 368(a). In the merger, the shareholders of Corporation X receive solely Corporation Y voting stock in exchange for their Corporation X stock. The fair market value of the Corporation X stock on August 9, 2010, is $310 per share.

In the merger, A's 100 shares of substantially vested Corporation X stock are exchanged for 100 shares of Corporation Y stock subject to a restriction that will cause the stock to be "substantially nonvested" within the meaning of § 1.83–3(b). Under this restriction, if A's employment with Corporation X is terminated for any reason before August 9, 2013, A must sell the substantially nonvested Corporation Y shares to Corporation Y in exchange for the lesser of $310 per share (the fair market value of the shares on August 9, 2010) or the fair market value at the time of forfeiture. In addition, the shares are nontransferable before that date. No other shareholder of Corporation X receives Corporation Y stock subject to a restriction.

A timely files an election under § 83(b) with respect to the substantially nonvested Corporation Y stock A receives in the merger.

A continues to be employed by Corporation X until August 9, 2013 at which time the fair market value of the stock is $500. A sells the stock on October 31, 2014 when the fair market value of the stock is $550 per share.

Situation 3. Assume the same facts as in *Situation 2* except that in the merger half of the Corporation X stock is exchanged for cash and half is exchanged for Corporation Y stock, the transaction is fully taxable, and all of A's Corporation X stock is exchanged for Corporation Y stock.

LAW

Section 83, provides that if, in connection with the performance of services, property is transferred to any person other than the service recipient, the excess of the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse), on the first day that the rights to the property are either transferable or not subject to a substantial risk of forfeiture, over the amount paid for the property is included in the service provider's gross income for the first taxable year in which the rights to the property are either transferable or not subject to a substantial risk of forfeiture.

Section 1.83–3(f) provides that property transferred to an employee or independent contractor (or beneficiary thereof) in recognition of the performance of, or the refraining from performance of, services is considered transferred in connection with the performance of services within the meaning of § 83. However, the existence of other persons entitled to buy stock on the same terms and conditions as an

employee, whether pursuant to a public or private offering, may indicate that in such circumstances a transfer to the employee is not in recognition of the performance of, or the refraining from performance of, services.

Subjecting stock to a restriction that will cause it to be "substantially nonvested" (within the meaning of § 1.83–3(b)) indicates that the property is transferred in connection with the performance of services even if the employee pays fair value for the stock. See *Alves v. Commissioner*, 734 F.2d 478 (9th Cir. 1984), *aff'g* 79 T.C. 864 (1982).

Section 1.83–1(a)(1) provides that property transferred in connection with the performance of services is not taxable under § 83(a) until it has been transferred (as defined in § 1.83–3(a)) to an employee or independent contractor and becomes substantially vested (as defined in § 1.83–3(b)) in such person. Until such property becomes substantially vested, the transferor is regarded as the owner of the property, and any income from such property received by the employee or independent contractor (or beneficiary thereof) or the right to the use of such property by the employee or independent contractor constitutes additional compensation and must be included in the gross income of such employee or independent contractor for the taxable year in which such income is received or such use is made available.

Section 83(b) provides that any person who has performed services in connection with which property is transferred to any person may elect to include in gross income, for the taxable year in which such property is transferred, the excess of the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse) over the amount paid for such property.

Section 1.83–2(a) provides, in part, that the fact that the transferee has paid full value for the property transferred, realizing no bargain element in the transaction, does not preclude the use of the election under § 83(b). If this election is made, the substantial vesting rules of § 83(a) and the regulations thereunder do not apply with respect to such property. Thus, with respect to such property, the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse) over the amount (if any) paid for such property is includible in gross income as compensation at the time of transfer, and no compensation will be includible in gross income when such property becomes substantially vested. An employee who makes an election under § 83(b) is considered to be the owner of the property. See Rev. Rul. 83–22, 1983–1 C.B. 17.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of the property is the sum of any money received plus the fair market value of the property (other than money) received.

Section 1001(c) provides, except as otherwise provided in Subtitle A, the entire amount of the gain or loss, determined under section 1001, on the sale or exchange of the property shall be recognized.

Section 1.83–3(g) provides that for purposes of § 83 and its regulations, the term "amount paid" refers to the value of any money or property paid for the transfer of property to which § 83 applies.

ANALYSIS — *Situation 1*

In *Situation 1*, in connection with the new investment, the substantially vested shares of Corporation X stock owned by A are subjected to a restriction causing them to be "substantially nonvested". Because the substantially vested shares of Corporation X stock are already owned by A for purposes of § 83, there is no "transfer" under § 83. Thus, the imposition of new restrictions on the substantially vested shares has no effect for purposes of § 83.

When the substantially nonvested Corporation X stock becomes substantially vested on July 9, 2009, A does not recognize compensation income under § 83(a). A's basis in the stock continues to be $1,000.

ANALYSIS — *Situation 2*

In *Situation 2*, A receives 100 shares of Corporation Y stock with an exchanged basis of $1,000 in the tax-free reorganization. Because the substantially vested Corporation X stock is exchanged for stock that is subjected to a restriction causing the shares to be "substantially nonvested," the substantially nonvested shares are treated as having been transferred in connection with the performance of services, and thus, are subject to § 83. As a result of the § 83(b) election, A becomes the owner of those shares.

The "amount paid" for the stock under § 83 on the transfer of the substantially nonvested shares is the fair market value of the substantially vested Corporation X stock exchanged for the substantially nonvested Corporation Y stock ($31,000) on the exchange date, August 9, 2010. On A's election under § 83(b), $31,000 is treated as the amount paid for the Corporation Y stock for purposes of applying § 83. On A's return for the 2010 taxable year, A does not report any taxable income from the transfer of the Corporation Y stock under the § 83(b) election because the fair market value of the stock less the amount paid is $0. A does not include any amount in compensation income in the 2013 taxable year when the stock becomes substantially vested because of the prior § 83(b) election. A's basis in the Corporation Y stock continues to be $1,000. Upon the sale of the shares in 2014, A recognizes capital gain of $54,000, the amount by which $55,000 ($550, the fair market value of the stock, x 100 shares) exceeds A's $1,000 basis in the shares.

ANALYSIS — *Situation 3*

In *Situation 3*, A holds substantially vested Corporation X stock with a basis of $1,000 at the time of the merger. A exchanges that substantially vested Corporation X stock for substantially nonvested Corporation Y stock with a fair market value of $310 per share in a taxable transaction. Because A disposed of the substantially vested Corporation X stock in exchange for substantially nonvested Corporation Y stock in an exchange to which § 1001 applies, A recognizes capital gain on the disposition of the Corporation X stock in the amount of $30,000 ($31,000

fair market value of substantially nonvested Corporation Y stock ($310 per share x 100 shares) less $1,000 basis in the Corporation X stock). A's basis in the Corporation Y stock is $31,000.

Because the substantially vested Corporation X stock is exchanged for Corporation Y stock that is subjected to a restriction causing the shares to be "substantially nonvested," the substantially nonvested shares are treated as having been transferred in connection with the performance of services, and thus, are subject to § 83.

As in *Situation 2*, the "amount paid" for the stock under § 83 is $31,000. When A makes an election under § 83(b) with respect to the Corporation Y stock, A does not report any additional amount of income for the 2010 taxable year as a result of such election because the fair market value of the stock less the amount paid for the stock is $0. A does not include any amount in compensation income in the 2013 taxable year when the stock becomes substantially vested because of the prior § 83(b) election. A's basis in the Corporation Y stock continues to be $31,000. On the sale of the 100 shares in 2014, A will recognize capital gain of $24,000, the amount by which $55,000 ($550, the sale price, x 100 shares) exceeds A's $31,000 basis in the shares.

If A had not made an election under § 83(b) with respect to the Corporation Y stock, when the stock becomes substantially vested on August 9, 2013, A would include $19,000 in gross income as compensation under § 83(a). This is the amount by which the fair market value of 100 Corporation Y shares ($50,000 or $500 per share) exceeds the amount paid for those shares ($31,000). Consequently, A's basis in the Corporation Y stock would be increased by $19,000 to $50,000. See § 1.83–4(b). On the sale of the 100 shares, A would recognize capital gain of $5,000, the amount by which $55,000 ($550, the sale price, x 100 shares) exceeds A's basis of $50,000 in the shares.

HOLDINGS

1) There is not a transfer of substantially nonvested stock subject to § 83 where restrictions imposed on substantially vested stock cause the substantially vested stock to become substantially nonvested.

2) There is a transfer of substantially nonvested stock subject to § 83 where a service provider exchanges substantially vested stock for substantially nonvested stock in a reorganization described in § 368(a).

3) There is a transfer of substantially nonvested stock subject to § 83 where a service provider exchanges substantially vested stock for substantially nonvested stock in a taxable stock acquisition.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jean Casey of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue ruling, contact Ms. Casey at (202) 622–6030 (not a toll-free call). For further information regarding issues with respect to subchapter C, contact Ms. Jean Brenner at (202) 622–7790 (not a toll-free number).

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-in Losses Following Ownership Change

26 CFR 1.382–7T: Built-in gains and losses (temporary).

T.D. 9330

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Built-in Gains and Losses Under Section 382(h)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that apply to corporations that have undergone ownership changes within the meaning of section 382. These regulations provide guidance regarding the treatment of prepaid income under the built-in gain provisions of section 382(h). The text of these temporary regulations also serves as the text of the proposed regulations (REG–144540–06) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on June 14, 2007.

Applicability Date: For dates of applicability, see §1.382–7T(b).

FOR FURTHER INFORMATION CONTACT: Keith Stanley at (202) 622–7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 382

Section 382 limits, after a more than 50 percent change in stock ownership (ownership change), the amount of a loss corporation's taxable income for any post-change year that may be offset by pre-change losses. The amount of the limitation each year is equal to the product of the fair market value of all the stock of the loss corporation immediately before the ownership change multiplied by the applicable long-term tax-exempt rate (section 382 limitation).

Section 382(h)(1)(A) provides that if the loss corporation has a net unrealized built-in gain (NUBIG), the section 382 limitation for any taxable year ending within a 5-year recognition period is increased by the recognized built-in gain (RBIG) for the taxable year, subject to the NUBIG limitation. Section 382(h)(2)(A) defines RBIG as any gain recognized during the 5-year recognition period on the disposition of any asset to the extent the loss corporation establishes that (i) it held the asset on the change date and (ii) such gain does not exceed the asset's built-in gain on the change date. Section 382(h)(6)(A) also treats as RBIG any item of income "properly taken into account during the recognition period" if the item is "attributable to periods before the change date."

In Notice 2003–65, 2003–2 C.B. 747, the IRS provided interim guidance regarding the identification of built-in gains and losses under section 382(h). The notice

provides, among other things, that a loss corporation may use the 338 approach in determining the amount of its RBIG or recognized built-in loss (RBIL) for purposes of section 382(h). The 338 approach identifies items of RBIG and RBIL generally by comparing the loss corporation's actual items of income, gain, deduction, and loss with those that would have resulted if a section 338 election had been made with respect to a hypothetical purchase of all of the outstanding stock of the loss corporation on the change date.

Prepaid Income

Generally, a taxpayer, including an accrual method taxpayer that receives payments in advance of performance, must include the payments in gross income in the taxable year of receipt without regard to whether the required performance has occurred. In *Schlude v. Commissioner*, 372 U.S. 128 (1963), the Supreme Court held that advance payments for dance lessons were includable in gross income when received because the payments were nonrefundable and the services were provided on demand of the student. In *American Automobile Association v. United States*, 367 U.S. 687 (1961), the Supreme Court held that membership dues entitling members to emergency road assistance and trip-planning services were includable in gross income when received, even though the taxpayer's method reflected income in accordance with generally accepted accounting principles (which generally operate to defer income recognition until the item is economically earned).

However, courts have allowed the deferral of prepaid income in limited circumstances. In *Artnell Co. v. Commissioner*, 400 F.2d 981 (7th Cir. 1968), the court held that amounts received on advance ticket sales relating to major league baseball games to be played on fixed dates in the next year could be deferred to that year. In *Tampa Bay Devil Rays, Ltd. v. Commissioner*, T.C. Memo 2002–248, the Tax Court held that deposits received by a new baseball franchise (Devil Rays) in 1995 and 1996 on advance season tickets for major league baseball games to be played by the Devil Rays in its first season in 1998 could be deferred until 1998, even though the deferral period was greater than a year. The Tax Court emphasized that the games were to be played on a fixed and definite schedule in 1998 and that deferral more clearly matched the deposits with the related expenses that were incurred and deducted in 1998.

Congress, the IRS, and Treasury Department have allowed deferral of prepaid income in certain circumstances. For example, section 455 allows taxpayers that have prepaid subscription income for newspapers, magazines, and other periodicals to elect to defer such income to the taxable years during which the liability to furnish or deliver the newspaper, magazine, or periodical exists. Section 1.451–5(b)(1)(ii) allows advance payments for the sale of goods to be deferred to the year the payments are included in gross receipts under the taxpayer's method of accounting for tax purposes (such as when the goods are shipped or delivered), unless the income is recorded earlier for purposes of the taxpayer's financial statements. For goods that must be inventoried, the permitted deferral is further limited by §1.451–5(c)(1) to the second year following the year substantial advance payments, as defined in §1.451–5(c)(3), are received.

Revenue Procedure 71–21, 1971–2 C.B. 549, which was modified and superseded by Rev. Proc. 2004–34, 2004–1 C.B. 991, allowed accrual method taxpayers that received a payment in one taxable year for services to be performed before the end of the next succeeding taxable year to defer income inclusion until the services were performed (but no later than the end of the succeeding taxable year). The stated purpose of the Revenue Procedure was to reconcile the tax accounting treatment of such payments with the financial accounting conventions consistently used by accrual method taxpayers in the treatment of such payments. Rev. Proc. 2004–34 allows a qualifying taxpayer to defer advance payments for services (and for certain non-services and combinations of services and non-services) to the taxable year succeeding the taxable year of receipt to the extent the taxpayer establishes that the advance payments are not recognized in revenues in the taxpayer's applicable financial statement in the taxable year of receipt; or, if the taxpayer does not have an applicable financial statement, the payment is not earned in the taxable year of receipt.

The common purpose of the prepaid income deferral provisions described above is to better match the taxpayer's income with the expenses incurred to earn that income and, as a result, to more clearly reflect the taxpayer's income both in the year of receipt and in the year of performance.

Certain taxpayers are taking the position that prepaid income received in the period before the change date (pre-change period) but included in gross income in the recognition period is RBIG. As further explained below, the IRS and Treasury Department believe that prepaid income is attributable to the period on or after the change date (post-change period) rather than the pre-change period. Thus, treating prepaid income as RBIG is inconsistent with the purposes of section 382(h).

Explanation of Provisions

This temporary regulation provides that prepaid income is not recognized built-in gain. The term prepaid income means any amount received prior to the change date that is attributable to performance occurring on or after the change date. Examples to which the temporary regulation applies include, but are not limited to, income received prior to the change date that is deferred under section 455, §1.451–5, or Rev. Proc. 2004–34 (or any successor revenue procedure).

The IRS and Treasury Department believe that the section 382 legislative history, through the examples set forth therein, supports the position that prepaid income should not be treated as RBIG for section 382 purposes. The House and Senate Committee Reports that accompanied the enactment of section 382(h)(6)(A) both state that items of income attributable to the pre-change period include accounts receivable of a cash basis taxpayer that arose before the change date and are collected after that date, the gain on completion of a long-term contract performed by a taxpayer using the completed contract method of accounting that is attributable to the pre-change period, and the recognition of income attributable to the pre-change period pursuant to section 481 adjustments, as when the loss corporation is required to change to the accrual method. See H. Rep. No. 100–795, 46 (1988); S. Rep. No. 100–445, 48 (1988).

The IRS and Treasury Department believe that prepaid income is distinguishable from the income items described in the committee report examples. In each of the committee report examples, the item of income is attributable to the pre-change period because that is the period in which performance occurred and expenses were incurred to earn the income. By contrast, prepaid income is attributable to the post-change period because that is the period in which performance occurred and expenses were incurred to earn the income. Therefore, because prepaid income is attributable to the post-change period rather than the pre-change period, the IRS and Treasury Department have determined that such prepaid income should not be treated as RBIG under section 382(h).

The 338 approach described in Notice 2003–65 hereinafter will be applied consistently with this temporary regulation.

Comments

The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. Please see the "Comments and Requests for a Public Hearing" section of the notice of proposed rulemaking for the procedures to follow in submitting comments on the proposed regulations on this subject.

In preparing comments on the proposed regulations, please consider the following. In Notice 2003–65, comments were requested regarding the different approaches, including the 338 approach, set forth for determining RBIG and RBIL under section 382(h). The IRS and Treasury Department believe the 338 approach, in most cases, will properly identify whether or not an item of income or deduction is treated as RBIG or RBIL. However, the IRS and Treasury Department are concerned that taking items of income and deduction into account separately may cause the 338 approach, in some cases, to not properly identify whether or not an item of income or deduction is treated as RBIG or RBIL. The purpose of section 382(h)(6) is to treat items of income or deduction in similar fashion to gain and loss under section 382(h)(2). However, under general tax principles, there is a fundamental difference between the treatment of items of income or deduction and items of gain or loss. On the one hand, under section 382(h)(2), which incorporates the principles of section 1001, gain or loss on the disposition of an asset is taken into account net of the taxpayer's basis, or investment, in the assets. In contrast, under section 382(h)(6), an item of income is generally a gross amount that is not netted and therefore not necessarily matched with the item of deduction incurred to earn the item of income.

Therefore, the IRS and Treasury Department request comments on the proposed regulations about identifying cases where taking into account items of income and deduction separately may cause the 338 approach to not properly identify whether or not an item of income or deduction is treated as RBIG or RBIL, and how the 338 approach might be adapted so that in such cases it properly identifies whether or not an item of income or deduction is treated as RBIG or RBIL.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. These temporary regulations address situations in which taxpayers inappropriately attempt to treat deferred prepaid income as net unrealized built-in gain for purposes of increasing the amount of post-ownership change income that may be offset by pre-ownership change losses. For this reason, it has been determined pursuant to 5 U.S.C. 553(b)(B) that prior notice and public procedure are impracticable and contrary to the public interest. For the same reason, it has been determined pursuant to 5 U.S.C. 553(d)(3) that good cause exists to make these temporary regulations effective upon the date of publication. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross-reference notice of the proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Sean McKeever, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

Availability of IRS Documents

IRS revenue rulings, procedures, and notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.382–7T also issued under 26 U.S.C. 382(m).* * *

Par. 2. Section 1.382–7T is added to read as follows:

§1.382–7T Built-in gains and losses (temporary).

(a) *Treatment of prepaid income.* For purposes of section 382(h), prepaid income is not recognized built-in gain. The term *prepaid income* means any amount received prior to the change date that is attributable to performance occurring on or after the change date. Examples to which this paragraph (a) will apply include, but are not limited to, income received prior to the change date that is deferred under section 455, §1.451–5, or Rev. Proc. 2004–34, 2004–1 C.B. 991 (or any successor revenue procedure) (see §601.601(d)(2) of this chapter).

(b) *Effective/Applicability date.* (1) This section applies to loss corporations that have undergone an ownership change on or after June 14, 2007.

(2) The applicability of this section expires on June 11, 2010.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 4, 2007.

Eric Solomon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 14, 2007, 72 F.R. 32792)

Section 954.—Foreign Base Company Income

26 CFR 1.954–2: Foreign personal holding company income.

T.D. 9326

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Under Subpart F Relating to Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of the temporary regulations.

SUMMARY: This document contains final regulations providing guidance under subpart F relating to partnerships. The final regulations add rules for determining whether a controlled foreign corporation's (CFC's) distributive share of partnership income is excluded from foreign personal holding company income under the exception contained in section 954(i). These regulations will affect CFCs that are qualified insurance companies, as defined in section 953(e)(3), that have an interest in a partnership and U.S. shareholders of such CFCs.

DATES: *Effective Date:* These regulations are effective July 13, 2007.

Applicability Date: For date of applicability, see §1.954–2(a)(5)(v).

FOR FURTHER INFORMATION CONTACT: Kate Y. Hwa, (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 17, 2006, the IRS and the Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG–106418–05, 2006–1 C.B. 461 [71 FR 2496]) by cross-reference to temporary regulations (T.D. 9240, 2006–1 C.B. 454 [71 FR 2462]) (collectively, the January 2006 regulations), which provide that a CFC's distributive share of partnership income will qualify for the exception contained in section 954(i) of the Internal Revenue Code (Code) if the CFC is a qualifying insurance company and the income of the partnership would have been qualified insurance income under section 954(i) if received by the CFC directly. Thus, whether the CFC partner's distributive share of partnership income is qualified insurance income is determined at the CFC partner level.

The IRS and the Treasury Department received no comments responding to the January 2006 regulations and no public hearing was requested or held. Accordingly, the proposed regulations are adopted without change by this Treasury decision and the corresponding temporary regulations are removed.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Kate Y. Hwa of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.954–2 is amended by revising paragraphs (a)(5)(ii)(C) and (a)(5)(iii) *Example 2*, to read as follows:

§1.954–2 Foreign personal holding company income.

(a) * * *

(5) * * *

(ii) * * *

(C) A controlled foreign corporation's distributive share of partnership income will not be excluded from foreign personal holding company income under the exception contained in section 954(i) unless the controlled foreign corporation is a qualifying insurance company, as defined in section 953(e)(3), and the income of the partnership would have been qualified insurance income, as defined in section 954(i)(2), if received by the controlled foreign corporation directly. See §1.952–1(g)(1).

(iii) * * *

Example 2. D Corp, a Country F corporation, is a controlled foreign corporation within the meaning of section 957(a). D Corp is a qualifying insurance company, within the meaning of section 953(e)(3), that is engaged in the business of issuing life insurance contracts. D Corp has reserves of $100x, all of which are allocable to exempt contracts, and $10x of surplus, which is equal to 10 percent of the reserves allocable to exempt contracts. D Corp contributed the $100x of reserves and $10x of surplus to DJ Partnership in exchange for a 40-percent partnership interest. DJ Partnership is an entity organized under the laws of Country G and is treated as a partnership under the laws of Country G and Country F. DJ Partnership earns $30x of investment income during the taxable year that is received from persons who are not related persons with respect to D Corp, within the meaning of section 954(d)(3). D Corp's distributive share of this investment income is

$12x. This income is treated as earned by D Corp in Country F under the tax laws of Country F and meets the definition of exempt insurance income in section 953(e)(1). This $12x of investment income would be qualified insurance income, under section 954(i)(2), if D Corp had received the income directly, because the $110x invested by D Corp in DJ Partnership is equal to D Corp's reserves allocable to exempt contracts under section 954(i)(2)(A) and allowable surplus under section 954(i)(2)(B)(ii). Thus, D Corp's distributive share of DJ Partnership's income will be excluded from foreign personal holding company income under section 954(i).

* * * * *

§1.954–2T [REMOVED]

Par. 3. Section 1.954–2T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2007, 72 F.R. 38474)

Part III. Administrative, Procedural, and Miscellaneous

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S.

26 CFR 601.602: Forms and instructions.
(Also Part 1, Sections 220, 408, 408A, 529, 530(h), 1441, 6041, 6041A, 6042, 6043, 6044, 6045, 6047, 6049, 6050A, 6050B, 6050D, 6050E, 6050H, 6050J, 6050N, 6050P, 6050Q, 6050R, 6050S, 1.408–5, 1.408–7, 1.408A–7, 1.1441–1 through 1.1441–5, 1.6041–1, 7.6041–1, 1.6042–2, 1.6042–4, 1.6044–2, 1.6044–5, 1.6045–1, 5f.6045–1, 1.6045–2, 1.6045–4, 1.6047–1, 1.6049–4, 1.6049–6, 1.6049–7, 1.6050A–1, 1.6050B–1, 1.6050D–1, 1.6050E–1, 1.6050H–1, 1.6050H–2, 1.6050J–1T, 1.6050N–1, 1.6050P–1.)

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Part 1
General Information

Section 1.1 — Overview of Revenue Procedure 2007–50

1.1.1 Purpose

The purpose of this revenue procedure is to set forth the 2007 requirements for:

- Using official Internal Revenue Service (IRS) forms to file information returns with the IRS,
- Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS, and
- Using official or acceptable substitute forms to furnish information to recipients.

1.1.2 Which Forms Are Covered?

This revenue procedure contains specifications for these information returns:

Form	Title
1096	Annual Summary and Transmittal of U.S. Information Returns
1098	Mortgage Interest Statement
1098-C	Contributions of Motor Vehicles, Boats, and Airplanes
1098-E	Student Loan Interest Statement
1098-T	Tuition Statement
1099-A	Acquisition or Abandonment of Secured Property
1099-B	Proceeds From Broker and Barter Exchange Transactions
1099-C	Cancellation of Debt
1099-CAP	Changes in Corporate Control and Capital Structure
1099-DIV	Dividends and Distributions
1099-G	Certain Government Payments
1099-H	Health Coverage Tax Credit (HCTC) Advance Payments
1099-INT	Interest Income
1099-LTC	Long-Term Care and Accelerated Death Benefits
1099-MISC	Miscellaneous Income
1099-OID	Original Issue Discount
1099-PATR	Taxable Distributions Received From Cooperatives
1099-Q	Payments From Qualified Education Programs (Under Sections 529 and 530)
1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
1099-S	Proceeds From Real Estate Transactions
1099-SA	Distributions From an HSA, Archer MSA, or Medicare Advantage MSA
5498	IRA Contribution Information
5498-ESA	Coverdell ESA Contribution Information
5498-SA	HSA, Archer MSA, or Medicare Advantage MSA Information

Form	Title
W-2G	Certain Gambling Winnings
1042-S	Foreign Person's U.S. Source Income Subject to Withholding

1.1.3 Scope

For purposes of this revenue procedure, a substitute form or statement is one that is not printed by the IRS. For a substitute form or statement to be acceptable to the IRS, it must conform to the official form or the specifications outlined in this revenue procedure. Do not submit any substitute forms or statements listed above to the IRS for approval. Privately printed forms may not state, "This is an IRS approved form."

Filers making payments to certain recipients during a calendar year are required by the Internal Revenue Code (the Code) to file information returns with the IRS for these payments. These filers must also provide this information to their recipients. In some cases, this also applies to payments received. See *Part 4* for specifications that apply to recipient statements (generally Copy B).

In general, section 6011 of the Code contains requirements for filers of information returns. A filer must file information returns on magnetic media, through electronic media, or on paper. A filer who is required to file 250 or more information returns of any one type during a calendar year must file those returns by magnetic media or electronic media.

Although not required, small volume filers (fewer than 250 returns during a calendar year) may file the forms on magnetic media or electronically. See the legal requirements for filing information returns (and providing a copy to a payee) in the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G and the 2007 Instructions for Form 1042-S. In addition, see the most recent revision of Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically*.

1.1.4 For More Information

The IRS prints and provides the forms on which various payments must be reported. Alternatively, filers may prepare substitute copies of these IRS forms and use such forms to report payments to the IRS.

- For copies of the official forms and instructions, call our toll-free number at 1-800-TAX-FORM (1-800-829-3676).
- The IRS operates a central call site to answer questions related to information returns, penalties, and backup withholding. The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m., Eastern time. For your convenience, you may call the toll-free number, 1-866-455-7438. You may still use the original telephone number, 304-263-8700 (not toll-free). For TTY/TDD equipment, call 304-267-3367 (not toll-free).
- For other tax information related to business returns or accounts, call 1-800-829-4933. If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax account questions or to order forms and publications.

1.1.5 What's New

The following changes have been made to this year's Revenue Procedure:

- Form 1042-S: New regulations under section 1.671-5 provide reporting rules for widely held fixed investment trusts (WHFITs). A new income code 37 has been added to report distributions that are a return of capital. Beginning with tax year 2008, processing year 2009, the IRS will no longer accept tape cartridges. In addition, you will not be able to use magnetic media to file Forms 1099, 1098, 5498, W-2G, and 1042-S.
- Form 1098: Box 4 has been revised and new box 5 added to comply with the new reporting requirements mandated by the Tax Relief and Health Care Act of 2006 section 419 (P.L. 109-432) requiring the reporting of certain mortgage insurance premiums paid or accrued after December 31, 2006. The previously untitled box 4 is now titled "Mortgage insurance premiums" and the legend on Copy B has been revised to include box 4 in the list of boxes containing information that is being furnished to the Internal Revenue Service.

A new box 5 has been added to serve the function previously performed by box 4. Box 5 is to be used by the filer to provide any information to the recipient that may be useful, but which is not required, such as the address of the property. A description of the new information has been added to the back of Copy B for box 4 and new box 5. Payers are, in the box 4 information, directed to the instructions for Schedule A (Form 1040) for additional information on the deductibility of mortgage insurance premiums.

- Final Regulations section 1.671-5(d) requires trustees and middlemen to file with the IRS the appropriate Form 1099 beginning with calender year 2007. The appropriate forms include Form 1099-DIV, 1099-B, 1099-INT, 1099-MISC or 1099-OID. For additional reporting information, see Part A in the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.
- Form 1099-G: A separate Form 1099-G is required to report distributions from a contributory program treated as unemployment compensation. For additional reporting information, see box 1, Unemployment compensation of, Form 1099-G instructions.
- Logos and advertising: The IRS has identified questionable information reporting forms, for instance the Form 1099 as a key indicator of potentially abusive and fraudulent returns. Some questionable information reporting forms may be confused with legitimate information reporting that carries logos and advertisements. The IRS has received questions concerning whether a logo or an identifying slogan for an employer or other preparer is acceptable on the substitute employee statements. We were also asked whether an advertisement for tax preparation software or other marketing materials are acceptable on, or attached to, the substitute employee statements. The IRS is continuing to solicit comments regarding these questions. The IRS anticipates responding to these questions by revising the regulations concerning this issue after the comments have been considered, and it will include requirements brought about by the regulations in a future update of this revenue procedure. Send your comments to:

  Internal Revenue Service
  Attn: Substitute Forms Program
  SE:W:CAR:MP:T:T:SP
  1111 Constitution Ave., NW
  Room 6406
  Washington DC 20224

Section 1.2 — General Requirements for Acceptable Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S

1.2.1 Introduction

Paper substitutes for Form 1096 and Copy A of Forms 1098, 1099, 5498, W-2G, and 1042-S that totally conform to the specifications listed in this revenue procedure may be privately printed and filed as returns with the IRS. The reference to the Department of the Treasury — Internal Revenue Service should be included on all such forms.

If you are uncertain of any specification and want it clarified, you may submit a letter citing the specification, stating your understanding and interpretation of the specification, and enclosing an example of the form (if appropriate) to:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP
1111 Constitution Ave., NW
Room 6406
Washington DC 20224

Note. Allow at least 30 days for the IRS to respond.

You may also contact the Substitute Forms Program via e-mail at **taxforms@irs.gov* (the asterisk must be included in the address). Please enter "Substitute Forms" on the Subject Line.

Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S are subject to annual review and possible change. Therefore, filers are cautioned against overstocking supplies of privately printed substitutes. The specifications contained in this revenue procedure apply to 2007 forms only.

1.2.2 Copy A Specifications

Proposed substitutes of Copy A must be an exact replica of the official IRS form with respect to layout and content. Proposed substitutes for Copy A that do not conform to the specifications in this revenue procedure are not acceptable. Further, if you file such forms with the IRS, you may be subject to a penalty for failure to file a correct information return under section 6721 of the Code. Generally, the penalty is $50 for each return where such failure occurs (up to $250,000). No IRS office is authorized to allow deviations from this revenue procedure.

Caution: Overuse of proportional fonts may cause you to be subject to penalties and delays in processing.

1.2.3 Copy B and Copy C Specifications

Copies B and Copies C of the following forms must contain the information in *Part 4* to be considered a "statement" or "official form" under the applicable provisions of the Code. The format of this information is at the discretion of the filer with the exception of the location of the tax year, form number, form name, and the information for composite Form 1099 statements as outlined under *Section 4.2.*

Copy B, of the forms below, are for the following recipients.

Form	Recipient
1098	For Payer
1098-C	For Donor
1098-E; 1099-A	For Borrower
1098-T	For Student
1099-C	For Debtor
1099-CAP	For Shareholder
1099-LTC	For Policyholder
1099-R; W-2G	Indicates that these forms may require Copy B to be attached to the federal income tax return.
1099-S	For Transferor
All other Forms 1099; 1042-S	For Recipient
5498; 5498-SA	For Participant
5498-ESA	For Beneficiary

Copy C of the following forms are:

Form	Recipient
1098-C	For Donor's Records
1099-CAP	For Corporation
1099-LTC	For Insured
1099-R	For Recipient's Records
All other Forms 1099	See *Section 4.4.2*
5498-ESA	For Trustee
W-2G	For Winner's Records

Note. On Copy C, Form 1099-LTC, you may reverse the locations of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.

Section 1.3 — Definitions

1.3.1 Form Recipient

Form recipient means the person to whom you are required by law to furnish a copy of the official form or information statement. The form recipient may be referred to by different names on various Forms 1099 and related forms ("payer," "borrower," "student," "debtor," "policyholder," "insured," "transferor," "recipient," "participant," "donor," or, in the case of Form W-2G, the "winner"). See *Section 1.2.3,* earlier.

1.3.2 Filer

Filer means the person or organization required by law to file a form listed in *Section 1.1.2* with the IRS. As outlined earlier, a filer may be a payer, creditor, recipient of mortgage or student loan interest payments, educational institution, broker, barter exchange, person reporting real estate transactions, trustee or issuer of any individual retirement arrangement or medical savings account, lender who acquires an interest in secured property or who has reason to know that the property has been abandoned, or certain donees of motor vehicles, boats, and airplanes.

1.3.3 Substitute Form

Substitute form means a paper substitute of Copy A of an official form listed in *Section 1.1.2* that totally conforms to the provisions in this revenue procedure.

1.3.4 Substitute Form Recipient Statement

Substitute form recipient statement means a paper statement of the information reported on a form listed in *Section 1.1.2.* This statement must be furnished to a person (form recipient), as defined under the applicable provisions of the Code and the applicable regulations.

1.3.5 Composite Substitute Statement

Composite substitute statement means one in which two or more required statements (for example, Forms 1099-INT and 1099-DIV) are furnished to the recipient on one document. However, each statement must be designated separately and must contain all the requisite Form 1099 information except as provided under *Section 4.2.* A composite statement may not be filed with the IRS.

Part 2
Specifications for Substitute Forms 1096 and Copies A of Forms 1098, 1099, and 5498 (All Filed with the IRS)

Section 2.1 — Specifications

2.1.1 General Requirements

Form identifying numbers (for example, 9191 for Form 1099-DIV) must be printed in nonreflective black carbon-based ink in print positions 15 through 19 using an OCR A font. The check boxes to the right of the form identifying numbers must be 10-point boxes. The "VOID" checkbox is in print position 25. The "CORRECTED" check box is in position 33. Measurements are from the left edge of the paper, not including the perforated strip. See *Exhibits E* and *N.*

The substitute form must be an exact replica of the official IRS form with respect to layout and content. To determine the correct form measurements, see *Exhibits A* through *Z* at the end of this publication.

Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply.

Use of chemical transfer paper for Copy A is acceptable.

The Government Printing Office (GPO) symbol must be deleted.

2.1.2 Color and Paper Quality

Color and paper quality for Copy A (cut sheets and continuous pinfeed forms) as specified by JCP Code 0–25, dated November 29, 1978, must be white 100% bleached chemical wood, optical character recognition (OCR) bond produced in accordance with the following specifications.

Note. Reclaimed fiber in any percentage is permitted provided the requirements of this standard are met.

- Acidity: Ph value, average, not less than............................ 4.5
- Basis Weight: 17 x 22-500 cut sheets 18-20
- Metric equivalent–g/m^2 75

  A tolerance of ±5 pct. is allowed.
- Stiffness: Average, each direction, not less than-milligrams........... 50
- Tearing strength: Average, each direction, not less than-grams 40
- Opacity: Average, not less than-percent 82
- Thickness: Average-inch 0.0038
- Metric equivalent-mm.. 0.097

  A tolerance of +0.0005 inch (0.0127 mm) is allowed. Paper cannot vary more than 0.0004 inch (0.0102 mm) from one edge to the other.
- Porosity: Average, not less than-seconds 10
- Finish (smoothness): Average, each side-seconds..................... 20-55
- For information only, the Sheffield equivalent-units.................. 170-100
- Dirt: Average, each side, not to exceed-parts per million 8

2.1.3 Chemical Transfer Paper

Chemical transfer paper is permitted for Copy A only if the following standards are met:

- Only chemically backed paper is acceptable for Copy A. Front and back chemically treated paper cannot be processed properly by machine.
- Carbon-coated forms are not permitted.
- Chemically transferred images must be black.

All copies must be clearly legible. Hot wax and cold carbon spots are not permitted for Copy A. Interleaved carbon should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

2.1.4 Printing

All print on Copy A of Forms 1098, 1099, 5498, and the print on Form 1096 above the statement, “Return this entire page to the Internal Revenue Service. Photocopies are not acceptable.” must be in Flint J–6983 red OCR dropout ink or an exact match. However, the four-digit form identifying number must be in nonreflective carbon-based black ink in OCR A font.

The shaded areas of any substitute form should generally correspond to the format of the official form.

The printing for the Form 1096 statement and the following text may be in any shade or tone of black ink. Black ink should only appear on the lower part of the reverse side of Form 1096, where it will not bleed through and interfere with scanning.

Note. The instructions on the front and back of Form 1096, which include filing addresses, must be printed.

Separation between fields must be 0.1 inch.

Except for Form 1099-R and 1099-MISC, the numbered captions are printed as solid with no shaded background.

Other printing requirements are discussed below.

2.1.5 OCR Specifications

The contractor must initiate or have a quality control program to assure OCR ink density. Readings will be made when printed on approved 20 lb. white OCR bond with a reflectance of not less than 80%. Black ink must not have a reflectance greater than 15%. These readings are based on requirements of the "Scan-Optics Series 9000" Optical Scanner using Flint J–6983 red OCR dropout ink or an exact match.

The following testers and ranges are acceptable:

- *MacBeth PCM-II.* The tested Print Contrast Signal (PCS) values when using the MacBeth PCM-II tester on the "C" scale must range from .01 minimum to .06 maximum.
- *Kidder 082A.* The tested PCS values when using the Kidder 082A tester on the Infra Red (IR) scale must range from .12 minimum to .21 maximum. White calibration disc must be 100%. Sensitivity must be set at one (1).
- *Alternative testers.* Alternative testers must be approved by the government so that tested PCS values can be established. You may obtain approval by writing to the following address:

  Commissioner of Internal Revenue
  Attn: SE:W:CAR:MP:P:B:T
  Business Publishing – Tax Products
  1111 Constitution Ave., NW
  Washington DC 20224

2.1.6 Typography

Type must be substantially identical in size and shape to the official form. All rules are either 1/2-point or 3/4-point. Rules must be identical to those on the official IRS form.

Note. The form identifying number must be nonreflective carbon-based black ink in OCR A font.

2.1.7 Dimensions

Generally, three Forms 1098, 1099, or 5498 (Copy A) are contained on a single page, 8 inches wide (without any snap-stubs and/or pinfeed holes) by 11 inches deep.

Exceptions. Forms 1099-B, 1099-DIV, 1099-MISC, 1099-R, and 1042-S contain two documents per page. Form 1098-C is a single page document.

There is a .33 inch top margin from the top of the corrected box, and a .25 inch right margin. There is a 1/32 (0.0313) inch tolerance for the right margin. If the right and top margins are properly aligned, the left margin for all forms will be correct. All margins must be free of print. See *Exhibits A* through *Z* in this publication for the correct form measurements.

These measurements are constant for certain Forms 1098, 1099, and 5498. These measurements are shown only once in this publication, on Form 1098 (Exhibit B). Exceptions to these measurements are shown on the rest of the exhibits.

The depth of the individual trim size of each form on a page must be 3 2/3 inches, the same depth as the official form.

Exceptions. The depth of Forms 1099-B, 1099-DIV, 1099-MISC, 1099-R, and 1042-S is 5 1/2 inches.

2.1.8 Perforation

Copy A (three per page; two per page for Forms 1099-B, 1099-DIV, 1099-MISC, 1099-R, and 1042-S) of privately printed continuous substitute forms must be perforated at each 11" page depth. No perforations are allowed between the 3 2/3" forms (5 1/2" for Forms 1099-B, 1099-DIV, 1099-MISC, or 1099-R) on a single copy page of Copy A.

The words "Do Not Cut or Separate Forms on This Page" must be printed in red dropout ink (as required by form specifications) between the three forms (two for Forms 1099-B, 1099-DIV, 1099-MISC, or 1099-R).

Note. Perforations are required between all the other individual copies (Copies B and C, and Copies 1 and 2 for Forms 1099-R and 1099-MISC, and Copy D for Forms 1099-LTC and 1099-R) in the set.

2.1.9 What To Include

You must include the OMB Number on Copies A and Form 1096 in the same location as on the official form.

The words "For Privacy Act and Paperwork Reduction Act Notice, see the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G" must be printed on Copy A; "For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G" must be printed on Form 1096.

A postal indicia may be used if it meets the following criteria:

- It is printed in the OCR ink color prescribed for the form, and
- No part of the indicia is within one print position of the scannable area.

The printer's symbol (GPO) must not be printed on substitute Copy A. Instead, the employer identification number (EIN) of the forms printer must be entered in the bottom margin on the face of each individual form of Copy A, or on the bottom margin on the back of each Form 1096.

The Catalog Number (Cat. No.) shown on the 2007 forms is used for IRS distribution purposes and need not be printed on any substitute forms.

The form must not contain the statement "IRS approved" or any similar statement.

Section 2.2 –– Instructions for Preparing Paper Forms That Will Be Filed with the IRS

2.2.1 Recipient Information

The form recipient's name, street address, city, state, ZIP code, and telephone number (if required) should be typed or machine printed in black ink in the same format as shown on the official IRS form. The city, state, and ZIP code must be on the same line.

The following rules apply to the form recipient's name(s):

- The name of the appropriate form recipient must be shown on the first or second name line in the area provided for the form recipient's name.
- No descriptive information or other name may precede the form recipient's name.
- Only one form recipient's name may appear on the first name line of the form.

- If the multiple recipients' names are required on the form, enter on the first name line the recipient name that corresponds to the recipient taxpayer identification number (TIN) shown on the form. Place the other form recipients' names on the second name line (only 2 name lines are allowable).

Because certain states require that trust accounts be provided in a different format, generally filers should provide information returns reflecting payments to trust accounts with the:

- Trust's employer identification number (EIN) in the recipient's TIN area,
- Trust's name on the recipient's first name line, and
- Name of the trustee on the recipient's second name line.

Although handwritten forms will be accepted, the IRS prefers that filers type or machine print data entries. Also, filers should insert data in the middle of blocks well separated from other printing and guidelines, and take measures to guarantee clear, dark black, sharp images. Carbon copies and photocopies are not acceptable.

2.2.2 Account Number Box

Use the account number box on all Forms 1098, 1099, 5498, and W-2G for an account number designation when required by the official IRS form. The account number is required if you have multiple accounts for a recipient for whom you are filing more than one information return of the same type. Additionally, the IRS encourages you to include the recipients' account number on paper forms if your system of records uses the account number rather than the name or TIN for identification purposes. Also, the IRS will include the account number in future notices to you about backup withholding. If you use window envelopes and a reduced rate to mail statements to recipients, be sure the account number does not appear in the window. Otherwise, the Postal Service may not accept them for mailing.

Exception. Form 1098-T can have third party provider information.

2.2.3 Specifications and Restrictions

Machine-printed forms should be printed using a 6 lines/inch option, and should be printed in 10 pitch pica (10 print positions per inch) or 12 pitch elite (12 print positions per inch). Proportional spaced fonts are unacceptable.

Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single sheet before they are filed with the IRS. The size specified does not include pin feed holes. Pin feed holes must not be present on forms filed with the IRS.

Do not:

- Use a felt tip marker. The machine used to "read" paper forms generally cannot read this ink type.
- Use dollar signs ($), ampersands (&), asterisks (*), commas (,), or other special characters in the numbered money boxes.
  Exception. Use decimal points to indicate dollars and cents (for example, 2000.00 is acceptable).
- Use apostrophes ('), asteriks (*), or other special characters on the payee name line.
- Fold Forms 1098, 1099, or 5498 mailed to the IRS. Mail these forms flat in an appropriately sized envelope or box. Folded documents cannot be readily moved through the machine used in IRS processing.
- Staple Forms 1096 to the transmitted returns. Any staple holes near the return code number may impair the IRS's ability to machine scan the type of documents.
- Type other information on Copy A.
- Cut or separate the individual forms on the sheet of forms of Copy A (except Forms W-2G).

2.2.4 Where To File

Mail completed paper forms to the IRS service center shown in the Instructions for Form 1096 and in the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G. Specific information needed to complete the forms mentioned in this revenue procedure are given in the specific form instructions. A chart is included in the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G giving a quick guide to which form must be filed to report a particular payment.

Part 3
Specifications for Substitute Form W-2G (Filed with the IRS)

Section 3.1 — General

3.1.1 Purpose

The following specifications give the format requirements for substitute Form W-2G (Copy A only), which is filed with the IRS.

A filer may use a substitute Form W-2G to file with the IRS (referred to as "substitute Copy A"). The substitute form must be an exact replica of the official form with respect to layout and content.

Section 3.2 — Specifications for Copy A of Form W-2G

3.2.1 Substitute Form W-2G (Copy A)

You must follow these specifications when printing substitute Copy A of the Form W-2G.

Item	Substitute Form W-2G (Copy A)
Paper Color and Quality	Paper for Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 x 22-500), plus or minus 5 percent. The paper must consist substantially of bleached chemical wood pulp. It must be free from unbleached or ground wood pulp or post-consumer recycled paper. It also must be suitably sized to accept ink without feathering.
Ink Color and Quality	All printing must be in a high quality non gloss black ink.
Typography	The type must be substantially identical in size and shape to the official form. All rules on the document are either 1/2 point (.007 inch), 1 point (0.015 inch), or 3 point (0.045 inch). Vertical rules must be parallel to the left edge of the document, horizontal rules to the top edge.
Dimensions	The official form is 8 inches wide x 3 2/3 inches deep, exclusive of a 2/3 inch snap stub on the left side of the form. Any substitute Copy A must be the same dimensions. The snap feature is not required on substitutes. All margins must be free of print. The top and right margins must be 1/4 inch plus or minus .0313. If the top and right margins are properly aligned, the left margin for all forms will be correct. If the substitute forms are in continuous or strip form, they must be burst and stripped to conform to the size specified for a single form.

Item	Substitute Form W-2G (Copy A)
Hot Wax and Cold Carbon Spots	Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply. Interleaved carbons, if used, should be black and of good quality to avoid smudging.
Printer's Symbol	The Government Printing Office (GPO) symbol must not be printed on substitute Forms W-2G. Instead, the employer identification number (EIN) of the form's printer must be printed in the bottom margin on the face of each individual Copy A on a sheet. The form must not contain the statement "IRS approved" or any similar statement.
Catalog Number	The Catalog Number (Cat. No.) shown on Form W-2G is used for IRS distribution purposes and need not be printed on any substitute forms.

Part 4
Substitute Statements to Form Recipients and Form Recipient Copies

Section 4.1 — Specifications

4.1.1 Introduction

If you do not use the official IRS form to furnish statements to recipients, you must furnish an acceptable substitute statement. To be acceptable, your substitute statement must comply with the rules in this section. If you are furnishing a substitute form, see Regulations sections 1.6042-4, 1.6044-5, 1.6049-6, and 1.6050N-1 to determine how the following statements must be provided to recipients for most Forms 1099-DIV and 1099-INT, all Forms 1099-OID and 1099-PATR, and Form 1099-MISC or 1099-S for royalties. Generally, information returns may be furnished electronically with the consent of the recipient. See Section 4.5.1.

Note. A trustee of a grantor-type trust may choose to file Forms 1099 and furnish a statement to the grantor under Regulations sections 1.671-4(b)(2)(iii) and (b)(3)(ii). The statement required by those regulations is not subject to the requirements outlined in this section.

4.1.2 Substitute Statements to Recipients for Certain Forms 1099-INT and 1099-DIV, and for Forms 1099-OID and 1099-PATR

The rules in this section apply to Form 1099-INT (except for interest reportable under section 6041), 1099-DIV (except for section 404(k) dividends), 1099-OID, and 1099-PATR only. You may furnish form recipients with Copy B of the official Form 1099 or a substitute Form 1099 (form recipient statement) if it contains the same language as the official IRS form (such as aggregate amounts paid to the form recipient, any backup withholding, the name, address, and TIN of the person making the return, and any other information required by the official form). Except for state income tax withholding information, information not required by the official form should not be included on the substitute form.

You may enter a total of the individual accounts listed on the form only if they have been paid by the same payer. For example, if you are listing interest paid on several accounts by one financial institution on Form 1099-INT, you may also enter the total interest amount. You may also enter a date next to the corrected box if that box is checked.

A substitute form recipient statement for Forms 1099-INT, 1099-DIV, 1099-OID, or 1099-PATR must comply with the following requirements:

(1) Box captions and numbers that are applicable must be clearly identified, using the same wording and numbering as on the official form.
Note. For Form 1099-INT, if box 3 is not on your substitute form, you may drop "not included in box 3" from the box 1 caption.

(2) The form recipient statement (Copy B) must contain all applicable form recipient instructions provided on the front and back of the official IRS form. You may provide those instructions on a separate sheet of paper.

(3) The form recipient statement must contain the following in bold and conspicuous type: **This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.**

(4) The box caption **"Federal income tax withheld"** must be in boldface type on the form recipient statement.

(5) The form recipient statement must contain the Office of Management and Budget (OMB) number as shown on the official IRS form. See *Part 5.*

(6) The form recipient statement must contain the tax year (for example, 2007), form number (for example, Form 1099-INT), and form name (for example, Interest Income) of the official IRS Form 1099. This information must be displayed prominently together in one area of the statement. For example, the tax year, form number, and form name could be shown in the upper right part of the statement. Each copy must be appropriately labeled (such as Copy B, For Recipient). See *Section 4.4* for applicable labels and arrangement of assembly of forms.

Note. Do not include the words "Substitute for" or "In lieu of" on the form recipient statement.

(7) Layout and format of the form is at the discretion of the filer. However, the IRS encourages the use of boxes so that the statement has the appearance of a form and can be easily distinguished from other non-tax statements.

(8) Each recipient statement of Forms 1099-DIV, 1099-INT, 1099-OID, and 1099-PATR must include the direct access telephone number of an individual who can answer questions about the statement. Include that telephone number conspicuously anywhere on the recipient statement.

(9) A mutual fund family may state separately on one document (for example, one piece of paper) the dividend income earned by a recipient from each fund within the family of funds as required by Form 1099-DIV. However, each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund's dividends and name, not the name of the mutual fund family, must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds. In addition, a mutual fund family may furnish a single statement (as a single filer) for Forms 1099-INT, 1099-DIV, and 1099-OID information. Each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund's earnings and name, not the name of the mutual fund family, must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.

4.1.3 Substitute Statements to Recipients for Certain Forms 1098, 1099, 5498, and W-2G

Statements to form recipients for Forms 1098, 1098-C, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-CAP, 1099-G, 1099-H, 1099-LTC, 1099-MISC, 1099-Q, 1099-R, 1099-S, 1099-SA, 5498, 5498-ESA, 5498-SA, W-2G, 1099-DIV (only for section 404(k) dividends reportable under section 6047), and 1099-INT (only for interest of $600 or more made in the course of a trade or business reportable under section 6041) can be copies of the official forms or an acceptable substitute.

Caution. The IRS does not require a donee to use Form 1098-C as the written acknowledgment for contributions of motor vehicles, boats, and airplanes. However, if you choose to use copies of Form 1098-C or an acceptable substitute as the written acknowledgment, then you must follow the requirements of this section 4.1.3.

To be acceptable, a substitute form recipient statement must meet the following requirements.

(1) The tax year, form number, and form name must be the same as the official form and must be displayed prominently together in one area on the statement. For example, they may be shown in the upper right part of the statement.

(2) The filer's and the form recipient's identifying information required on the official IRS form must be included.

(3) Each substitute recipient statement for Forms W-2G, 1098, 1098-C, 1098-E, 1098-T, 1099-A, 1099-B, 1099-CAP, 1099-DIV, 1099-G (excluding state and local income tax refunds), 1099-H, 1099-INT, 1099-LTC, 1099-MISC (excluding fishing boat proceeds), 1099-OID, 1099-PATR, 1099-Q, and 1099-S must include the direct access telephone number of an individual who can answer questions about the statement. Include the telephone number conspicuously anywhere on the recipient statement. Although not required, payers reporting on Forms 1099-C, 1099-R, 1099-SA, 5498, 5498-ESA, and 5498-SA are encouraged to furnish telephone numbers.

(4) All applicable money amounts and information, including box numbers, required to be reported to the form recipient must be titled on the form recipient statement in substantially the same manner as those on the official IRS form. The box caption "Federal income tax withheld" must be in boldface type on the form recipient statement.

Exception. If you are reporting a payment as "Other income" in box 3 of Form 1099-MISC, you may substitute appropriate language for the box title. For example, for payments of accrued wages and leave to a beneficiary of a deceased employee, you might change the title of box 3 to "Beneficiary payments" or something similar.

Note. You cannot make this change on Copy A.

Note. If federal income tax is withheld and shown on Form 1099-R or W-2G, Copy B and Copy C must be furnished to the recipient. If federal income tax is not withheld, only Copy C of Form 1099-R and W-2G must be furnished. However, for Form 1099-R, instructions similar to those on the back of the official Copy B and Copy C of Form 1099-R must be furnished to the recipient. For convenience, you may choose to provide both Copies B and C of Form 1099-R to the recipient.

(5) You must provide appropriate instructions to the form recipient similar to those on the official IRS form, to aid in the proper reporting on the form recipient's income tax return. For payments reported on Forms 1099-B, and 1099-CAP, the requirement to include instructions substantially similar to those on the official IRS form may be satisfied by providing form recipients with a single set of instructions for all Forms 1099-B and 1099-CAP statements required to be furnished in a calendar year.

(6) If you use carbonless sets to produce recipient statements, the quality of each copy in the set must meet the following standards:

- All copies must be clearly legible,
- All copies must be able to be photocopied, and
- Fading must not diminish legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred, but other colors are permitted if the above standards are met. Hot wax and cold carbon spots are not permitted on any of the internal form plies. The back of a mailer top envelope ply may contain these spots.

(7) A mutual fund family may state separately on one document (for example, one piece of paper) the Form 1099-B information for a recipient from each fund as required by Form 1099-B. However, the gross proceeds, etc., from each transaction within a fund must be stated separately. The form must contain an instruction to the recipient that each fund's (not the mutual fund family's) name and amount must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.

(8) You may use a Uniform Settlement Statement (under the Real Estate Settlement Procedures Act of 1974 (RESPA)) for Form 1099-S. The Uniform Settlement Statement is acceptable as the written statement to the transferor if you include the legend for Form 1099-S in *Section 4.3.2* and indicate which information on the Uniform Settlement Statement is being reported to the IRS on Form 1099-S.

(9) For reporting state income tax withholding and state payments, you may add an additional box(es) to recipient copies as appropriate.

Note. You cannot make this change on Copy A.

(10) On Copy C of Form 1099-LTC, you may reverse the location of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.

(11) If an institution insurer uses a third party service provider to file Form 1098-T, then in addition to the institution or insurers name, address, and telephone number, the same information may be included for the third party service provider in the space provided on the form.

4.2.1 Composite Substitute Statements for Certain Forms 1099-INT, 1099-DIV, 1099-MISC, and 1099-S, and for Forms 1099-OID and 1099-PATR

A composite form recipient statement is permitted for reportable payments of interest, dividends, original issue discount, patronage dividends, and royalties (Forms 1099-INT (except for interest reportable under section 6041), 1099-DIV (except for section 404(k) dividends), 1099-MISC or 1099-S (for royalties only), 1099-OID, or 1099-PATR) when one payer is reporting more than one of these payments during a calendar year to the same form recipient. Generally, do not include any other Form 1099 information (for example, 1098 or 1099-A) on a composite statement with the information required on the forms listed in the preceding sentence.

Exception. A filer may include Form 1099-B information on a composite form with the forms listed above.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the following requirements in addition to the requirements listed earlier in *Section 4.1.2.*

- All information pertaining to a particular type of payment must be located and blocked together on the form and separate from any information covering other types of payments included on the form. For example, if you are reporting interest and dividends, the Form 1099-INT information must be presented separately from the Form 1099-DIV information.
- The composite form recipient statement must prominently display the tax year, form number, and form name of the official IRS form together in one area at the beginning of each appropriate block of information.
- Any information required by the official IRS forms that would otherwise be repeated in each information block is required to be listed only once in the first information block on the composite form. For example, there is no requirement to report the name of the filer in each information block. This rule does not apply to any money amounts (for example, federal income tax withheld) or to any other information that applies to money amounts.
- A composite statement is an acceptable substitute only if the type of payment and the recipient's tax obligation with respect to the payment are as clear as if each required statement were furnished separately on an official form.

4.2.2 Composite Substitute Statements to Recipients for Forms Specified in Section 4.1.3

A composite form recipient statement for the forms specified in *Section 4.1.3* is permitted when one filer is reporting more than one type of payment during a calendar year to the same form recipient. A composite statement is not allowed for a combination of forms listed in *Section 4.1.3* and forms listed in *Section 4.1.2*.

Exceptions:

- Substitute payments in lieu of dividends reported in Box 8 of Form 1099-MISC may be reported on a composite substitute statement with Form 1099-DIV.
- Form 1099-B information may be reported on a composite form with the forms specified in *Section 4.1.2* as described in *Section 4.2.1*.
- Forms 1099-A and 1099-C transactions, if related, may be combined on Form 1099-C.
- Royalties reported on Form 1099-MISC or 1099-S may be reported on a composite form only with the forms specified in Section 4.1.2.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the requirements listed in *Section 4.2.1* as well as the requirements in *Section 4.1.3.* A composite statement of Forms 1098 and 1099-INT (for interest reportable under section 6049) is not allowed.

Section 4.3 — Required Legends

4.3.1 Required Legends for Forms 1098

Form 1098 recipient statements (Copy B) must contain the following legends:

- Form 1098—

(1) "The information in boxes 1, 2, 3, and 4 is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points or because you did not report this refund of interest on your return."

(2) "**Caution.** The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person."

- Form 1098-C:

  Copy B — "In order to take a deduction of more than $500 for this contribution, you must attach this copy to your federal tax return."

  Copy C — "This information is being furnished to the Internal Revenue Service unless box 7 is checked."

- Form 1098-E — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for student loan interest."
- Form 1098-T — "This is important tax information and is being furnished to the Internal Revenue Service."

4.3.2 Required Legends for Forms 1099 and W-2G

- Forms 1099-A, 1099-C, and 1099-CAP:

  Copy B — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported."

- Forms 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, and 1099-Q:

  Copy B — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported."

- Forms 1099-H:

  Copy B — "This is important tax information and is being furnished to the Internal Revenue Service."

- Form 1099-LTC:

  Copy B — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."

  Copy C — "Copy C is provided to you for information only. Only the policyholder is required to report this information on a tax return."

- Form 1099-R:

  Copy B — "Report this income on your federal tax return. If this form shows federal income tax withheld in box 4, attach this copy to your return."

  Copy C — "This information is being furnished to the Internal Revenue Service."

- Form 1099-S:

  Copy B — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."

- Form 1099-SA:
  Copy B — "This information is being furnished to the Internal Revenue Service."
- Form W-2G:
  Copy B — "This information is being furnished to the Internal Revenue Service. Report this income on your federal tax return. If this form shows federal income tax withheld in box 2, attach this copy to your return."
  Copy C — "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported."

4.3.3 Required Legends for Forms 5498

Form 5498 recipient statements (Copy B) must contain the following legends:

- Form 5498 — "This information is being furnished to the Internal Revenue Service."
  Note. If you do not furnish another statement to the participant because no contributions were made for the year, the statement of the fair market value and any required minimum distribution, of the account must contain this legend and a designation of which information is being furnished to the IRS.
- Form 5498-ESA — "The information in boxes 1 and 2 is being furnished to the Internal Revenue Service."
- Form 5498-SA — "The information in boxes 1 through 6 is being furnished to the Internal Revenue Service."

Section 4.4 — Miscellaneous Instructions for Copies B, C, D, 1, and 2

4.4.1 Copies

Copies B, C, and in some cases, D, 1, and 2 are included in the official assembly for the convenience of the filer. You are not legally required to include all these copies with the privately printed substitute forms. Furnishing Copies B and, in some cases, C will satisfy the legal requirement to provide statements of information to form recipients.

Note. If an amount of federal income tax withheld is shown on Form 1099-R or W-2G, Copy B (to be attached to the tax return) and Copy C must be furnished to the recipient. Copy D (Forms 1099-R and W-2G) may be used for filer records. Only Copy A should be filed with the IRS.

4.4.2 Arrangement of Assembly

Copy A ("For Internal Revenue Service Center") of all forms must be on top. The rest of the assembly must be arranged, from top to bottom, as follows. For:

- Form 1098 — Copy B "For Payer"; Copy C "For Recipient."
- Form 1098-C — Copy B "For Donor"; Copy C "For Donor's Records"; Copy D "For Donee."
- Form 1098-E — Copy B "For Borrower"; Copy C "For Recipient."
- Form 1098-T — Copy B "For Student"; Copy C "For Filer."
- Form 1099-A — Copy B "For Borrower"; Copy C "For Lender."
- Forms 1099-B, 1099-DIV, 1099-G, 1099-H, 1099-INT, 1099-OID, 1099-PATR, 1099-Q, and 1099-SA — Copy B "For Recipient"; Copy C "For Payer."
- Form 1099-C — Copy B "For Debtor"; Copy C "For Creditor."
- Form 1099-CAP — Copy B "For Shareholder"; Copy C "For Corporation."
- Form 1099-LTC — Copy B "For Policyholder"; Copy C "For Insured"; and Copy D "For Payer."
- Form 1099-MISC — Copy 1 "For State Tax Department"; Copy B "For Recipient"; Copy 2 "To be filed with recipient's state income tax return, when required"; and Copy C "For Payer."

- Form 1099-R — Copy 1 "For State, City, or Local Tax Department"; Copy B "Report this income on your federal tax return. If this form shows federal income tax withheld in box 4, attach this copy to your return"; Copy C "For Recipient's Records"; Copy 2 "File this copy with your state, city, or local income tax return, when required"; Copy D "For Payer."
- Form 1099-S — Copy B "For Transferor"; Copy C "For Filer."
- Form 5498 — Copy B "For Participant"; Copy C "For Trustee or Issuer."
- Form 5498-ESA — Copy B "For Beneficiary"; Copy C "For Trustee."
- Form 5498-SA — Copy B "For Participant"; Copy C "For Trustee."
- Form W-2G — Copy 1 "For State Tax Department"; Copy B "Report this income on your federal tax return. If this form shows federal income tax withheld in box 2, attach this copy to your return"; Copy C "For Winner's Records"; Copy 2 "Attach this copy to your state income tax return, if required."; Copy D "For Payer."

4.4.3 Perforations

Perforations are required between forms on all copies except Copy A to make separating the forms easier. (Copy A of Form W-2G may be perforated.)

Section 4.5 — Electronic Delivery of Form 1099 and Form 5498 Payee Statements

4.5.1 Electronic Recipient Statements

If you are required to furnish a written statement (Copy B or an acceptable substitute) to a recipient, then you may furnish the statement electronically instead of on paper. This includes furnishing the statement to recipients of Forms 1098, 1098-E, 1098-T, 1099-A, B, C, CAP, DIV, H, INT, G, LTC, MISC, OID, PATR, Q, R, S, SA, 5498, 5498-ESA, and 5498-SA. It also includes Form W-2G (except for horse and dog racing, jai alai, sweepstakes, wagering pools, and lotteries).

Note. Until further guidance is issued, you can not furnish Form 1098-C electronically.

If you meet the requirements listed below, you are treated as furnishing the statement timely.

Consent

The recipient must consent in the affirmative and not have withdrawn the consent before the statement is furnished. The consent by the recipient must be made electronically in a way that shows that he or she can access the statement in the electronic format in which it will be furnished.

You must notify the recipient of any hardware or software changes prior to furnishing the statement. A new consent to receive the statement electronically is required after the new hardware or software is put into service.

Prior to furnishing the statements electronically, you must provide the recipient a statement with the following statements prominently displayed:

- If the recipient does not consent to receive the statement electronically, a paper copy will be provided.
- The scope and duration of the consent. For example, whether the consent applies to every year the statement is furnished or only for the January 31 immediately following the date of the consent.
- How to obtain a paper copy after giving consent.
- How to withdraw the consent. The consent may be withdrawn at any time by furnishing the withdrawal in writing (electronically or on paper) to the person whose name appears on the statement. Confirmation of the withdrawal also will be in writing (electronically or on paper).
- Notice of termination. The notice must state under what conditions the statements will no longer be furnished to the recipient.

- Procedures to update the recipient's information.
- A description of the hardware and software required to access, print and retain a statement, and a date the statement will no longer be available on the website.

Format, Posting, and Notification

Additionally, you must:

- Ensure the electronic format contains all the required information and complies with the guidelines in this document.
- Post, on or before the January 31 due date, the applicable statement on a website accessible to the recipient through October 15 of that year.
- Inform the recipient, electronically or by mail, of the posting and how to access and print the statement.

For more information, see Regulations section 31.6051-1. For electronic furnishing of Forms 1098-E and 1098-T, see Regulations section 1.6050S-2. For electronic furnishing of Forms 1099-R, 1099-SA, 1099-Q, 5498, 5498-ESA, and 5498-SA, see Notice 2004-10, 2004-1 C.B. 433.

Part 5
Additional Instructions for Substitute Forms 1098, 1099, 5498, W-2G, and 1042-S

Section 5.1 — Paper Substitutes for Form 1042-S

5.1.1 Paper Substitutes

Paper substitutes of Copy A for Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, that totally conform to the specifications contained in this procedure may be privately printed without prior approval from the Internal Revenue Service. Proposed substitutes not conforming to these specifications must be submitted for consideration.

Note. Copies B, C, D, and E of Form 1042-S may contain multiple income entries for the same recipient, that is multiple rows of the top boxes 1-8 of the form.

5.1.2 Time Frame For Submission of Form 1042-S

The request should be submitted by November 15 of the year prior to the year the form is to be used. This is to allow the Service adequate time to respond and the submitter adequate time to make any corrections. These requests should contain a copy of the proposed form, the need for the specific deviation(s), and the number of information returns to be printed.

5.1.3 Revisions

Form 1042-S is subject to annual review and possible change. Withholding agents and form suppliers are cautioned against overstocking supplies of the privately printed substitutes.

5.1.4 Obtaining Copies

Copies of the official form for the reporting year may be obtained from most Service offices. The Service provides only cut sheets (no carbon interleaves) of these forms. Continuous fanfold/pin-fed forms are not provided.

5.1.5 Instructions For Withholding Agents

Instructions for withholding agents:

- Only original copies may be filed with the Service. Carbon copies and reproductions are not acceptable.
- The term "Recipient's U.S. TIN" for an individual means the social security number (SSN) or IRS individual taxpayer identification number (ITIN), consisting of nine digits separated by hyphens as follows: 000-00-0000. For all other recipients, the term means employer identification number (EIN) or qualified intermediary employer identification number (QI-EIN). The QI-EIN designation includes a withholding foreign partnership employer identification number (WP-EIN) and a withholding foreign trust employer identification

number (WT-EIN). The EIN and QI-EIN consist of nine digits separated by a hyphen as follows: 00-0000000. The taxpayer identification number (TIN) must be in one of these formats.

- Withholding agents are requested to type or machine print whenever possible, provide quality data entries on the forms (that is, use black ribbon and insert data in the middle of blocks well separated from other printing and guidelines), and take other measures to guarantee a clear, sharp image. Withholding agents are not required, however, to acquire special equipment solely for the purpose of preparing these forms.
- The "AMENDED" and "PRO-RATA BASIS REPORTING" boxes must be printed at the top center of the form under the title and checked, if applicable.
- Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single form before they are filed with the Service. The dimensions are found below. Computer cards are acceptable provided they meet all requirements regarding layout, content, and size.

5.1.6 Substitute Form 1042-S Format Requirements

Property	Substitute Form 1042-S Format Requirements
Printing	Privately printed substitute Forms 1042-S must be exact replicas of the official forms with respect to layout and content. Only the dimensions of the substitute form may differ. The Government Printing Office (GPO) symbol must be deleted. The exact dimensions are found below.
Box Entries	Only one item of income may be represented on the copy submitted to the Service (Copy A). Multiple income items may be shown on copies provided to recipients or retained by withholding agent. All boxes appearing on the official form must be present on the substitute form, with appropriate captions.
Color and Quality of Ink	All printing must be in high quality non-gloss black ink. Bar codes should be free from picks and voids.
Typography	Type must be substantially identical in size and shape to corresponding type on the official form. All rules on the document are either 1 point (0.015") or 3 point (0.045"). Vertical rules must be parallel to the left edge of the document; horizontal rules must be parallel to the top edge.
Carbons	Carbonized forms or "spot carbons" are not permissible. Interleaved carbons, if used, must be of good quality to preclude smudging and should be black.
Assembly	If all five parts are present, the parts of the assembly shall be arranged from top to bottom as follows: Copy A (Original) "for Internal Revenue Service," Copies B, C, and D "for Recipient," and Copy E "for Withholding Agent."
Color Quality of Paper	• Paper for Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 x 22–500), plus or minus 5 percent; or offset book paper, 50 pound (basis 25 x 38–500). No optical brighteners may be added to the pulp or paper during manufacture. The paper must consist of principally bleach chemical wood pulp or recycled printed paper. It also must be suitably sized to accept ink without feathering. • Copies B, C, D (for Recipient), and E (for Withholding Agent) are provided in the official assembly solely for the convenience of the withholding agent. Withholding agents may choose the format, design, color, and quality of the paper used for these copies.

Property	Substitute Form 1042-S Format Requirements
Dimensions	• The official form is 8 inches wide x 5½ inches deep, exclusive of a ½ inch snap stub on the left side of the form. The snap feature is not required on substitutes. • The width of a substitute Copy A must be a minimum of 7 inches and a maximum of 8 inches, although adherence to the size of the official form is preferred. If the width of substitute Copy A is reduced from that of the official form, the width of each field on the substitute form must be reduced proportionately. The left margin must be ½ inch and free of all printing other than that shown on the official form. • The depth of a substitute Copy A must be a minimum of 5⅙ inches and a maximum of 5½ inches.
Other Copies	Copies B, C, and D must be furnished for the convenience of payees who must send a copy of the form with other federal and state returns they file. Copy E may be used as a withholding agent's record/copy.

Section 5.2 — OMB Requirements for All Forms in This Revenue Procedure

5.2.1 OMB Requirements

The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires that:

- OMB approves all IRS tax forms that are subject to the Act. Each IRS form contains (in or near the upper right corner) the OMB approval number, if any. (The official OMB numbers may be found on the official IRS printed forms and are also shown on the forms in the exhibits in *Part 6*.)
- Each IRS form (or its instructions) states:

(1) Why the IRS needs the information,
(2) How it will be used, and
(3) Whether or not the information is required to be furnished to the IRS.

This information must be provided to any users of official or substitute IRS forms or instructions.

5.2.2 Substitute Form Requirements

The OMB requirements for substitute IRS forms are:

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Copy A, the OMB number must appear exactly as shown on the official IRS form.
- For any copy other than Copy A, the OMB number must use one of the following formats.

(1) OMB No. XXXX-XXXX (preferred) or
(2) OMB # XXXX-XXXX (acceptable).

5.2.3 Required Explanation to Users

All substitute forms (Copy A only) must state "For Privacy Act and Paperwork Reduction Act Notice, see the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G." (or "For Privacy Act and Paperwork Reduction Act Notice, see separate instructions." for Copy A of Form 1042-S).

If no instructions are provided to users of your forms, you must furnish them with the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 5.3 — Reproducible Copies of Forms

5.3.1 Introduction

You can order official IRS forms and publications by calling 1-800-TAX-FORM (1-800-829-3676). Other ways to get federal tax material include:

- The Internet.
- CD.
- GPO Superintendent of Documents Bookstores.

Note. Several IRS forms are provided electronically on the IRS home page and on the IRS Federal Tax Forms CD, but Form 1096, Copy A of the 1098 series, 1099 series, and 5498 series cannot be used for filing with the IRS when printed from a conventional printer. These forms contain drop-out ink requirements as described in Part 2 of this publication.

5.3.2 Internet

You can download tax materials from the Internet by visiting the IRS web site at *www.irs.gov*.

5.3.3 IRS Federal Tax Forms CD

The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its *IRS Federal Tax Forms CD*. The CD, Pub. 1796, *IRS Federal Tax Products CD*, will be available for the upcoming filing season. You may buy the CD on the Internet at *www.irs.gov/cdorders* or by calling 1-877-CDFORMS (1-877-233-6767).

5.3.4 GPO Supt. of Documents Bookstores

The Government Printing Office (GPO) Superintendent of Documents Bookstores also sell individual copies of tax forms, instructions, and publications.

Section 5.4 — Effect on Other Revenue Procedures

5.4.1 Other Revenue Procedures

Revenue Procedure 2007-15, 2007-3 I.R.B. 300, dated January 16, 2007, which provides rules and specifications for private printing of 2006 substitute forms and statements to recipients, is superseded.

Part 6
Exhibits

Section 6.1 — Exhibits of Forms in the Revenue Procedure

6.1.1 Purpose

Exhibits A through Z illustrate some of the specifications that were discussed earlier in this revenue procedure. The dimensions apply to the actual size forms, but the exhibits have been reduced in size.

Generally, the illustrated dimensions apply to all like forms. For example, Exhibit B shows 11.00" from the top edge to the bottom edge of Form 1098 and .85" between the bottom rule of the top form and the top rule of the second form on the page. These dimensions apply to all forms that are printed three to a page.

6.1.2 Guidelines

Keep in mind the following guidelines when printing substitute forms.

- Closely follow the specifications to avoid delays in processing the forms.
- Always use the specifications as outlined in this revenue procedure and illustrated in the exhibits.
- Do not add the text line "Do Not Cut or Separate Forms on This Page" to the bottom form. This will cause inconsistency with the specifications.

Exhibit A

.50"

Do Not Staple 6969

Form **1096**

Department of the Treasury
Internal Revenue Service

Annual Summary and Transmittal of U.S. Information Returns

OMB No 1545-0108

2007

FILER'S name

Street address (including room or suite number)

City, state, and ZIP code

1.33" 2.25" 7.30" 4.50"

Name of person to contact	Telephone number ( )
Email address	Fax number ( )

For Official Use Only

.35"

1 Employer identification number	2 Social security number	3 Total number of forms	4 Federal income tax withheld	5 Total amount reported with this Form 1096
1.40"	1.40"	1.20"	$ 1.40"	$ 1.90"

.25"

Enter an "X" in only one box below to indicate the type of form being filed.

If this is your **final return**, enter an "X" here . . ▶ ☐

W-2G 32	1098 81	1098-C 78	1098-E 84	1098-T 83	1099-A 80	1099-B 79	1099-C 85	1099-CAP 73	1099-DIV 91	1099-G 86	1099-H 71	1099-INT 92	1099-LTC 93
☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
1099-MISC 95	1099-OID 96	1099-PATR 97	1099-Q 31	1099-R 98	1099-S 75	1099-SA 94	5498 28	5498-ESA 72	5498-SA 27				
☐	☐	☐	☐	☐	☐	☐	☐	☐	☐				

Return this entire page to the Internal Revenue Service. Photocopies are not acceptable.

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

8.00"

Signature ▶ **Title ▶** **Date ▶**

11.0"

Instructions

Purpose of form. Use this form to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. Do not use Form 1096 to transmit electronically or magnetically. For magnetic media, see Form 4804, Transmittal of Information Returns Reported Magnetically; for electronic submissions, see Pub. 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically.

Who must file. The name, address, and TIN of the filer on this form must be the same as those you enter in the upper left area of Forms 1099, 1098, 5498, or W-2G. A filer includes a payer; a recipient of mortgage interest payments (including points) or student loan interest; an educational institution; a broker; a barter exchange; a creditor; a person reporting real estate transactions; a trustee or issuer of any individual retirement arrangement, a Coverdell ESA, an HSA, an Archer MSA (including a Medicare Advantage MSA); certain corporations; certain donees of motor vehicles, boats, and airplanes; and a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

Preaddressed Form 1096. If you received a preaddressed Form 1096 from the IRS with Package 1099, use it to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. If any of the preprinted information is incorrect, make corrections on the form.

If you are not using a preaddressed form, enter the filer's name, address (including room, suite, or other unit number), and TIN in the spaces provided on the form.

When to file. File Form 1096 as follows.

- With Forms 1099, 1098, or W-2G, file by February 28, 2008.
- With Forms 5498, 5498-ESA, or 5498-SA, file by June 2, 2008.

Where To File

Except for Form 1098-C, send all information returns filed on paper with Form 1096 to the following:

If your principal business, office or agency, or legal residence in the case of an individual, is located in	Use the following Internal Revenue Service Center address
Alabama, Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Texas, Vermont, Virginia, West Virginia	Austin, TX 73301
Alaska, California, Colorado, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maryland, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Washington, Wisconsin, Wyoming	Kansas City, MO 64999

For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.

Cat. No. 14400O

Form **1096** (2007)

Exhibit B

.65" .33" .50" 4.75" 3.33" 1.70" 2.80" .25" 3.40" 2.83"

8181 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-0901 **2007** Form **1098**	**Mortgage Interest Statement**
RECIPIENT'S federal identification no.	PAYER'S social security number	1 Mortgage interest received from payer(s)/borrower(s) $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PAYER'S/BORROWER'S name		2 Points paid on purchase of principal residence $	
Street address (including apt. no.)		3 Refund of overpaid interest $	
City, state, and ZIP code		4 Mortgage insurance premiums $	
Account number (see instructions)		5	

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

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7.30" 8.00" .85"

8181 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-0901 **2007** Form **1098**	**Mortgage Interest Statement**
RECIPIENT'S federal identification no.	PAYER'S social security number	1 Mortgage interest received from payer(s)/borrower(s) $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PAYER'S/BORROWER'S name		2 Points paid on purchase of principal residence $	
Street address (including apt. no.)		3 Refund of overpaid interest $	
City, state, and ZIP code		4 Mortgage insurance premiums $	
Account number (see instructions)		5	

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

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11.00"

8181 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-0901 **2007** Form **1098**	**Mortgage Interest Statement**
RECIPIENT'S federal identification no.	PAYER'S social security number	1 Mortgage interest received from payer(s)/borrower(s) $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PAYER'S/BORROWER'S name		2 Points paid on purchase of principal residence $	
Street address (including apt. no.)		3 Refund of overpaid interest $	
City, state, and ZIP code		4 Mortgage insurance premiums $	
Account number (see instructions)		5	

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

Exhibit C

7878 ☐ CORRECTED

DONEE'S name, street address, city, state, ZIP code, and telephone no.	1 Date of contribution	OMB No. 1545-1959 2007 Form 1098-C	Contributions of Motor Vehicles, Boats, and Airplanes
	2 Make, model, and year of vehicle 2.80"		
DONEE'S federal identification number / DONOR'S identification number 3.40"	3 Vehicle or other identification number		
DONOR'S name	4a ☐ Donee certifies that vehicle was sold in arm's length transaction to unrelated party		
Street address (including apt. no.)	4b Date of sale		
City, state, and ZIP code	4c Gross proceeds from sale (see instructions) $		Copy A For Internal Revenue Service Center File with Form 1096.

5a ☐ Donee certifies that vehicle will not be transferred for money, other property, or services before completion of material improvements or significant intervening use

5b ☐ Donee certifies that vehicle is to be transferred to a needy individual for significantly below fair market value in furtherance of donee's charitable purpose

7.16"

5c Donee certifies the following detailed description of material improvements or significant intervening use and duration of use

6a Did you provide goods or services in exchange for the vehicle? . . . . ▶ Yes ☐ No ☐

6b Value of goods and services provided in exchange for the vehicle
$

6c Describe the goods and services, if any, that were provided. If this box is checked, donee certifies that the goods and services consisted solely of intangible religious benefits . . . . ▶ ☐

7 Under the law, the donor may not claim a deduction of more than $500 for this vehicle if this box is checked . . . . ▶ ☐

For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form **1098-C** Cat. No. 39732R Department of the Treasury - Internal Revenue Service

Exhibit D

8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **2007** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $ 2.80"	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name 3.40"			
Street address (including apt. no.)			
City, state, and ZIP code 2.83"			
Account number (see instructions)		2 Check if box 1 includes loan origination fees and/or capitalized interest . . . . ☐	

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

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8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **2007** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (see instructions)		2 Check if box 1 includes loan origination fees and/or capitalized interest . . . . ☐	

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

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8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **2007** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (see instructions)		2 Check if box 1 includes loan origination fees and/or capitalized interest . . . . ☐	

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

Exhibit E

.33"

8383 ☐ VOID ☐ CORRECTED 6.25"

FILER'S name, street address, city, state, ZIP code, and telephone number	1 Payments received for qualified tuition and related expenses $	OMB No. 1545-1574 **2007** Form **1098-T**	**Tuition Statement**
	2 Amounts billed for qualified tuition and related expenses $		

FILER'S federal identification no.	STUDENT'S social security number	3 Check if you have changed your reporting method for 2007 ☐		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name 3.40"		4 Adjustments made for a prior year $	5 Scholarships or grants $ 1.40"	.25"
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year $ 2.80"	7 Check this box if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2008 ▶ ☐	
City, state, and ZIP code				
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student ☐	9 Check if a graduate student . . . ☐	10 Ins. contract reimb./refund $	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

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8383 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number	1 Payments received for qualified tuition and related expenses $	OMB No. 1545-1574 **2007** Form **1098-T**	**Tuition Statement**
	2 Amounts billed for qualified tuition and related expenses $		

FILER'S federal identification no.	STUDENT'S social security number	3 Check if you have changed your reporting method for 2007 ☐		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name		4 Adjustments made for a prior year $	5 Scholarships or grants $	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year $	7 Check this box if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2008 ▶ ☐	
City, state, and ZIP code				
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student ☐	9 Check if a graduate student . . . ☐	10 Ins. contract reimb./refund $	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

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8383 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number	1 Payments received for qualified tuition and related expenses $	OMB No. 1545-1574 **2007** Form **1098-T**	**Tuition Statement**
	2 Amounts billed for qualified tuition and related expenses $		

FILER'S federal identification no.	STUDENT'S social security number	3 Check if you have changed your reporting method for 2007 ☐		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name		4 Adjustments made for a prior year $	5 Scholarships or grants $	
Street address (including apt. no.)		6 Adjustments to scholarships or grants for a prior year $	7 Check this box if the amount in box 1 or 2 includes amounts for an academic period beginning January - March 2008 ▶ ☐	
City, state, and ZIP code				
Service Provider/Acct. No. (see instr.)	8 Check if at least half-time student ☐	9 Check if a graduate student . . . ☐	10 Ins. contract reimb./refund $	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

Exhibit F

8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no.		OMB No. 1545-0877 **2007** Form **1099-A**	**Acquisition or Abandonment of Secured Property**
LENDER'S federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name	3	4 Fair market value of property $ 1.40"	
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No 1.40"		
City, state, and ZIP code	6 Description of property 1.80"		
Account number (see instructions)			

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

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8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no		OMB No. 1545-0877 **2007** Form **1099-A**	**Acquisition or Abandonment of Secured Property**
LENDER'S federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name	3	4 Fair market value of property $	
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No		
City, state, and ZIP code	6 Description of property		
Account number (see instructions)			

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

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8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no.		OMB No. 1545-0877 **2007** Form **1099-A**	**Acquisition or Abandonment of Secured Property**
LENDER'S federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name	3	4 Fair market value of property $	
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No		
City, state, and ZIP code	6 Description of property		
Account number (see instructions)			

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

Exhibit G

7979 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale or exchange 1b CUSIP no.	OMB No. 1545-0715 **2007** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
	2 Stocks, bonds, etc $	Reported to IRS ☐ Gross proceeds ←1.90→ ☐ Gross proceeds less commissions and option premiums	
PAYER'S federal identification number / RECIPIENT'S identification number	3 Bartering $ ←3.90"→	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 No. of shares exchanged ←1.40"→	6 Classes of stock exchanged ←1.40"→	**File with Form 1096.**
Street address (including apt. no.)	7 Description		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	8 Profit or (loss) realized in 2007 $	9 Unrealized profit or (loss) on open contracts—12/31/2006 $	
CORPORATION'S name	10 Unrealized profit or (loss) on open contracts–12/31/2007 $	11 Aggregate profit or (loss) $	
Account number (see instructions) ←2.80"→ / 2nd TIN not. ☐	12 Check the box if recipient cannot take a loss on their tax return based on the amount in box 2 . . . . ☐ ←4.15"→		

Form **1099-B** ←.60"→ Cat. No. 14411V Department of the Treasury - Internal Revenue Service

7979 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale or exchange 1b CUSIP no.	OMB No. 1545-0715 **2007** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
	2 Stocks, bonds, etc. $	Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums	
PAYER'S federal identification number / RECIPIENT'S identification number	3 Bartering $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 No. of shares exchanged	6 Classes of stock exchanged	**File with Form 1096.**
Street address (including apt. no.)	7 Description		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	8 Profit or (loss) realized in 2007 $	9 Unrealized profit or (loss) on open contracts—12/31/2006 $	
CORPORATION'S name	10 Unrealized profit or (loss) on open contracts–12/31/2007 $	11 Aggregate profit or (loss) $	
Account number (see instructions) / 2nd TIN not. ☐	12 Check the box if recipient cannot take a loss on their tax return based on the amount in box 2 . . . . ☐		

Form **1099-B** Cat. No. 14411V Department of the Treasury - Internal Revenue Service

Exhibit H

8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code			OMB No. 1545-1424 **2007** Form **1099-C**	**Cancellation of Debt**
CREDITOR'S federal identification number	DEBTOR'S identification number	1 Date canceled 1.40"	2 Amount of debt canceled $ 1.40"	**Copy A For Internal Revenue Service Center**
DEBTOR'S name 3.40"		3 Interest if included in box 2 $	4	**File with Form 1096.**
Street address (including apt. no.)		5 Debt description		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code				
Account number (see instructions)		6 Check for bankruptcy ☐	7 Fair market value of property $	1.35"

Form **1099-C** Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code			OMB No. 1545-1424 **2007** Form **1099-C**	**Cancellation of Debt**
CREDITOR'S federal identification number	DEBTOR'S identification number	1 Date canceled	2 Amount of debt canceled $	**Copy A For Internal Revenue Service Center**
DEBTOR'S name		3 Interest if included in box 2 $	4	**File with Form 1096.**
Street address (including apt. no.)		5 Debt description		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code				
Account number (see instructions)		6 Check for bankruptcy ☐	7 Fair market value of property $	

Form **1099-C** Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code			OMB No. 1545-1424 **2007** Form **1099-C**	**Cancellation of Debt**
CREDITOR'S federal identification number	DEBTOR'S identification number	1 Date canceled	2 Amount of debt canceled $	**Copy A For Internal Revenue Service Center**
DEBTOR'S name		3 Interest if included in box 2 $	4	**File with Form 1096.**
Street address (including apt. no.)		5 Debt description		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code				
Account number (see instructions)		6 Check for bankruptcy ☐	7 Fair market value of property $	

Form **1099-C** Cat. No. 26280W Department of the Treasury - Internal Revenue Service

Exhibit I

7373 ☐ VOID ☐ CORRECTED

CORPORATION'S name, street address, city, state, ZIP code, and telephone no.

1 Date of sale or exchange

2 Aggregate amount received
$ ←1.40"→

OMB No. 1545-1814

2007

Form 1099-CAP

Changes in Corporate Control and Capital Structure

3 No. of shares exchanged

4 Classes of stock exchanged ←1.40"→

←1.35"→

Copy A For Internal Revenue Service Center

File with Form 1096.

For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

CORPORATION'S federal identification no.

SHAREHOLDER'S identification no.

SHAREHOLDER'S name

Street address (including apt. no.)

City, state, and ZIP code ←3.40"→

5

Account number (see instructions)

6 Check the box if this shareholder cannot claim a loss based on the amount in box 2 . . . . . . ☐

Form **1099-CAP** Cat. No. 35115M Department of the Treasury - Internal Revenue Service

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7373 ☐ VOID ☐ CORRECTED

CORPORATION'S name, street address, city, state, ZIP code, and telephone no.

1 Date of sale or exchange

2 Aggregate amount received
$

OMB No. 1545-1814

2007

Form 1099-CAP

Changes in Corporate Control and Capital Structure

3 No. of shares exchanged

4 Classes of stock exchanged

Copy A For Internal Revenue Service Center

File with Form 1096.

For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

CORPORATION'S federal identification no.

SHAREHOLDER'S identification no.

SHAREHOLDER'S name

Street address (including apt. no.)

City, state, and ZIP code

5

Account number (see instructions)

6 Check the box if this shareholder cannot claim a loss based on the amount in box 2 . . . . . . ☐

Form **1099-CAP** Cat. No. 35115M Department of the Treasury - Internal Revenue Service

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7373 ☐ VOID ☐ CORRECTED

CORPORATION'S name, street address, city, state, ZIP code, and telephone no.

1 Date of sale or exchange

2 Aggregate amount received
$

OMB No. 1545-1814

2007

Form 1099-CAP

Changes in Corporate Control and Capital Structure

3 No. of shares exchanged

4 Classes of stock exchanged

Copy A For Internal Revenue Service Center

File with Form 1096.

For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

CORPORATION'S federal identification no.

SHAREHOLDER'S identification no.

SHAREHOLDER'S name

Street address (including apt. no.)

City, state, and ZIP code

5

Account number (see instructions)

6 Check the box if this shareholder cannot claim a loss based on the amount in box 2 . . . . . . ☐

Form **1099-CAP** Cat. No. 35115M Department of the Treasury - Internal Revenue Service

Exhibit J

9191 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1a Total ordinary dividends $ 1b Qualified dividends 1.40" $	OMB No. 1545-0110 2007 Form 1099-DIV	Dividends and Distributions
		2a Total capital gain distr. $	2b Unrecap. Sec. 1250 gain $	Copy A For Internal Revenue Service Center File with Form 1096.
PAYER'S federal identification number	RECIPIENT'S identification number			
RECIPIENT'S name		2c Section 1202 gain $	2d Collectibles (28%) gain $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
		3 Nondividend distributions $	4 Federal income tax withheld $	
Street address (including apt. no.)			5 Investment expenses $	
City, state, and ZIP code		6 Foreign tax paid $	7 Foreign country or U.S. possession	
Account number (see instructions) 2.80"	2nd TIN not. ☐	8 Cash liquidation distributions $	9 Noncash liquidation distributions 4.50" $	

Form 1099-DIV Cat. No. 14415N Department of the Treasury - Internal Revenue Service

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9191 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1a Total ordinary dividends $ 1b Qualified dividends $	OMB No. 1545-0110 2007 Form 1099-DIV	Dividends and Distributions
		2a Total capital gain distr. $	2b Unrecap. Sec. 1250 gain $	Copy A For Internal Revenue Service Center File with Form 1096.
PAYER'S federal identification number	RECIPIENT'S identification number			
RECIPIENT'S name		2c Section 1202 gain $	2d Collectibles (28%) gain $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
		3 Nondividend distributions $	4 Federal income tax withheld $	
Street address (including apt. no.)			5 Investment expenses $	
City, state, and ZIP code		6 Foreign tax paid $	7 Foreign country or U.S. possession	
Account number (see instructions)	2nd TIN not. ☐	8 Cash liquidation distributions $	9 Noncash liquidation distributions $	

Form 1099-DIV Cat. No. 14415N Department of the Treasury - Internal Revenue Service

Exhibit K

8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation ←1.40"→ $ 2 State or local income tax refunds, credits, or offsets $	OMB No. 1545-0120 **2007** Form **1099-G**	**Certain Government Payments**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	**Copy A** ←1.10"→ **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 ATAA payments $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 Check if box 2 is trade or business income ▸ ☐	
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation $ 2 State or local income tax refunds, credits, or offsets $	OMB No. 1545-0120 **2007** Form **1099-G**	**Certain Government Payments**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 ATAA payments $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 Check if box 2 is trade or business income ▸ ☐	
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation $ 2 State or local income tax refunds, credits, or offsets $	OMB No. 1545-0120 **2007** Form **1099-G**	**Certain Government Payments**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 ATAA payments $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 Check if box 2 is trade or business income ▸ ☐	
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

Exhibit L

7171 ☐ VOID ☐ CORRECTED

ISSUER'S/PROVIDER'S name, street address, city, state, ZIP code, and telephone no.	1 Amount of HCTC advance payments $ 2 No. of mos. HCTC advance payments received	OMB No. 1545-1813 **2007** Form **1099-H**	**Health Coverage Tax Credit (HCTC) Advance Payments**
ISSUER'S/PROVIDER'S federal identification no. / RECIPIENT'S identification number	3 Jan. $	9 July ←1.40"→ $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Feb. $	10 Aug. $	
←3.40"→	5 Mar. $	11 Sept. $	
Street address (including apt. no.)	6 Apr ←1.40"→ $	12 Oct. $	
City, state, and ZIP code	7 May $	13 Nov $	
	8 June $	14 Dec. $	

Form **1099-H** Cat. No. 34912D Department of the Treasury - Internal Revenue Service

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7171 ☐ VOID ☐ CORRECTED

ISSUER'S/PROVIDER'S name, street address, city, state, ZIP code, and telephone no.	1 Amount of HCTC advance payments $ 2 No. of mos. HCTC advance payments received	OMB No. 1545-1813 **2007** Form **1099-H**	**Health Coverage Tax Credit (HCTC) Advance Payments**
ISSUER'S/PROVIDER'S federal identification no. / RECIPIENT'S identification number	3 Jan. $	9 July $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Feb. $	10 Aug. $	
	5 Mar. $	11 Sept. $	
Street address (including apt. no.)	6 Apr. $	12 Oct. $	
City, state, and ZIP code	7 May $	13 Nov. $	
	8 June $	14 Dec. $	

Form **1099-H** Cat. No. 34912D Department of the Treasury - Internal Revenue Service

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7171 ☐ VOID ☐ CORRECTED

ISSUER'S/PROVIDER'S name, street address, city, state, ZIP code, and telephone no.	1 Amount of HCTC advance payments $ 2 No. of mos. HCTC advance payments received	OMB No. 1545-1813 **2007** Form **1099-H**	**Health Coverage Tax Credit (HCTC) Advance Payments**
ISSUER'S/PROVIDER'S federal identification no / RECIPIENT'S identification number	3 Jan. $	9 July $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Feb $	10 Aug $	
	5 Mar. $	11 Sept. $	
Street address (including apt. no.)	6 Apr. $	12 Oct. $	
City, state, and ZIP code	7 May $	13 Nov. $	
	8 June $	14 Dec. $	

Form **1099-H** Cat. No. 34912D Department of the Treasury - Internal Revenue Service

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Exhibit M

9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional) 1 Interest income $ 2 Early withdrawal penalty $	OMB No. 1545-0112 **2007** Form **1099-INT**	**Interest Income**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Interest on U.S. Savings Bonds and Treas. obligations $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Federal income tax withheld 1.40" $	5 Investment expenses $	
Street address (including apt. no.)	6 Foreign tax paid $	7 Foreign country or U.S. possession	
City, state, and ZIP code	8 Tax-exempt interest	9 Specified private activity bond interest	
Account number (see instructions) 2.80" / 2nd TIN not. ☐ .60"	$	$ 4.15"	

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional) 1 Interest income $ 2 Early withdrawal penalty $	OMB No. 1545-0112 **2007** Form **1099-INT**	**Interest Income**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Interest on U.S. Savings Bonds and Treas. obligations $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Federal income tax withheld $	5 Investment expenses $	
Street address (including apt. no.)	6 Foreign tax paid $	7 Foreign country or U.S. possession	
City, state, and ZIP code	8 Tax-exempt interest	9 Specified private activity bond interest	
Account number (see instructions) / 2nd TIN not. ☐	$	$	

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional) 1 Interest income $ 2 Early withdrawal penalty $	OMB No. 1545-0112 **2007** Form **1099-INT**	**Interest Income**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Interest on U.S. Savings Bonds and Treas. obligations $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	4 Federal income tax withheld $	5 Investment expenses $	
Street address (including apt. no.)	6 Foreign tax paid $	7 Foreign country or U.S. possession	
City, state, and ZIP code	8 Tax-exempt interest	9 Specified private activity bond interest	
Account number (see instructions) / 2nd TIN not. ☐	$	$	

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

Exhibit N

9393 ← ☐ VOID ☐ CORRECTED 4.50" →

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $ 2 Accelerated death benefits paid $	OMB No. 1545-1519 **2007** Form **1099-LTC**	**Long-Term Care and Accelerated Death Benefits**
PAYER'S federal identification number / POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no ← 1.40" →	**Copy A For Internal Revenue Service Center**
POLICYHOLDER'S name ← 3.40" →	INSURED'S name		**File with Form 1096.**
Street address (including apt. no.)	Street address (including apt. no.) ← 2.80" →		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	City, state, and ZIP code		
Account number (see instructions) / 4 Qualified contract ☐ (optional)	5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill	Date certified	

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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9393 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $ 2 Accelerated death benefits paid $	OMB No. 1545-1519 **2007** Form **1099-LTC**	**Long-Term Care and Accelerated Death Benefits**
PAYER'S federal identification number / POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no	**Copy A For Internal Revenue Service Center**
POLICYHOLDER'S name	INSURED'S name		**File with Form 1096.**
Street address (including apt. no.)	Street address (including apt. no.)		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	City, state, and ZIP code		
Account number (see instructions) / 4 Qualified contract ☐ (optional)	5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill	Date certified	

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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9393 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $ 2 Accelerated death benefits paid $	OMB No. 1545-1519 **2007** Form **1099-LTC**	**Long-Term Care and Accelerated Death Benefits**
PAYER'S federal identification number / POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no.	**Copy A For Internal Revenue Service Center**
POLICYHOLDER'S name	INSURED'S name		**File with Form 1096.**
Street address (including apt. no.)	Street address (including apt. no.)		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	City, state, and ZIP code		
Account number (see instructions) / 4 Qualified contract ☐ (optional)	5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill	Date certified	

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

Exhibit O

.3125

.50"

9595 ☐ VOID ☐ CORRECTED

5.50"

4.50"

1.40"

.25

3.40"

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $ 2 Royalties $	OMB No. 1545-0115 **2007** Form **1099-MISC**	**Miscellaneous Income**
	3 Other income $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
PAYER'S federal identification number / RECIPIENT'S identification number	5 Fishing boat proceeds $	6 Medical and health care payments $	**File with Form 1096.**
RECIPIENT'S name	7 Nonemployee compensation $	8 Substitute payments in lieu of dividends or interest $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐	10 Crop insurance proceeds $	
City, state, and ZIP code	11	12	
Account number (see instructions) / 2nd TIN not. ☐	13 Excess golden parachute payments $	14 Gross proceeds paid to an attorney $	
15a Section 409A deferrals $ / **15b** Section 409A income $	16 State tax withheld $ $	17 State/Payer's state no.	18 State income $ $

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

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1.00"

.45"

9595 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $ 2 Royalties $	OMB No. 1545-0115 **2007** Form **1099-MISC**	**Miscellaneous Income**
	3 Other income $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
PAYER'S federal identification number / RECIPIENT'S identification number	5 Fishing boat proceeds $	6 Medical and health care payments $	**File with Form 1096.**
RECIPIENT'S name	7 Nonemployee compensation $	8 Substitute payments in lieu of dividends or interest $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐	10 Crop insurance proceeds $	
City, state, and ZIP code	11	12	
Account number (see instructions) / 2nd TIN not. ☐	13 Excess golden parachute payments $	14 Gross proceeds paid to an attorney $	
15a Section 409A deferrals $ / **15b** Section 409A income $	16 State tax withheld $ $	17 State/Payer's state no.	18 State income $ $

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

Exhibit P

9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 2007 ←1.40"→ $ 2 Other periodic interest $	OMB No. 1545-0117 **2007** Form **1099-OID**	**Original Issue Discount**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Description		**File with Form 1096.**
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	7 Investment expenses $		
Account number (see instructions) ←2.80"→ / 2nd TIN not. ☐	←4.15"→		

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 2007 $ 2 Other periodic interest $	OMB No. 1545-0117 **2007** Form **1099-OID**	**Original Issue Discount**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Description		**File with Form 1096.**
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	7 Investment expenses $		
Account number (see instructions) / 2nd TIN not. ☐			

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 2007 $ 2 Other periodic interest $	OMB No. 1545-0117 **2007** Form **1099-OID**	**Original Issue Discount**
PAYER'S federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Description		**File with Form 1096.**
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	7 Investment expenses $		
Account number (see instructions) / 2nd TIN not. ☐			

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

Exhibit Q

9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Patronage dividends 1.40" $	OMB No. 1545-0118 2007 Form 1099-PATR	Taxable Distributions Received From Cooperatives
		2 Nonpatronage distributions $		
		3 Per-unit retain allocations $		
PAYER'S federal identification number	RECIPIENT'S identification number	4 Federal income tax withheld $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		5 Redemption of nonqualified notices and retain allocations $	6 Domestic production activities deduction $	
Street address (including apt. no.)			7 Investment credit $	
City, state, and ZIP code		8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (see instructions) 2.80"	2nd TIN not. ☐	10 Other credits and deductions $ 4.15"		

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Patronage dividends $	OMB No. 1545-0118 2007 Form 1099-PATR	Taxable Distributions Received From Cooperatives
		2 Nonpatronage distributions $		
		3 Per-unit retain allocations $		
PAYER'S federal identification number	RECIPIENT'S identification number	4 Federal income tax withheld $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		5 Redemption of nonqualified notices and retain allocations $	6 Domestic production activities deduction $	
Street address (including apt. no.)			7 Investment credit $	
City, state, and ZIP code		8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (see instructions)	2nd TIN not. ☐	10 Other credits and deductions $		

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Patronage dividends $	OMB No. 1545-0118 2007 Form 1099-PATR	Taxable Distributions Received From Cooperatives
		2 Nonpatronage distributions $		
		3 Per-unit retain allocations $		
PAYER'S federal identification number	RECIPIENT'S identification number	4 Federal income tax withheld $		**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		5 Redemption of nonqualified notices and retain allocations $	6 Domestic production activities deduction $	
Street address (including apt. no.)			7 Investment credit $	
City, state, and ZIP code		8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (see instructions)	2nd TIN not. ☐	10 Other credits and deductions $		

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

Exhibit R

4.5"

3131 ☐ VOID ☐ CORRECTED

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number	1 Gross distribution 1.4" $ 2 Earnings $	OMB No. 1545-1760 **2007** Form **1099-Q**	**Payments From Qualified Education Programs (Under Sections 529 and 530)**
2.83" 3.4"			
PAYER'S/TRUSTEE'S federal identification no. | RECIPIENT'S social security number	3 Basis $	4 Trustee-to-trustee transfer ☐ 1.4"	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Check one: • Qualified tuition program— Private ☐ or State ☐ • Coverdell ESA ☐	6 Check if the recipient is not the designated beneficiary ☐ 3.25"	**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-Q** Cat. No. 32223J Department of the Treasury - Internal Revenue Service

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3131 ☐ VOID ☐ CORRECTED

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number	1 Gross distribution $ 2 Earnings $	OMB No. 1545-1760 **2007** Form **1099-Q**	**Payments From Qualified Education Programs (Under Sections 529 and 530)**
PAYER'S/TRUSTEE'S federal identification no. | RECIPIENT'S social security number	3 Basis $	4 Trustee-to-trustee transfer ☐	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Check one: • Qualified tuition program— Private ☐ or State ☐ • Coverdell ESA ☐	6 Check if the recipient is not the designated beneficiary ☐	**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-Q** Cat. No. 32223J Department of the Treasury - Internal Revenue Service

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3131 ☐ VOID ☐ CORRECTED

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number	1 Gross distribution $ 2 Earnings $	OMB No. 1545-1760 **2007** Form **1099-Q**	**Payments From Qualified Education Programs (Under Sections 529 and 530)**
PAYER'S/TRUSTEE'S federal identification no. | RECIPIENT'S social security number	3 Basis $	4 Trustee-to-trustee transfer ☐	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Check one: • Qualified tuition program— Private ☐ or State ☐ • Coverdell ESA ☐	6 Check if the recipient is not the designated beneficiary ☐	**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

Form **1099-Q** Cat. No. 32223J Department of the Treasury - Internal Revenue Service

Exhibit S

.3125 .50"

5.50" 4.50"

9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution ← 1.40" → $	OMB No. 1545-0119 **2007** Form **1099-R**	**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
		2a Taxable amount $		
		2b Taxable amount not determined ☐ ← 2.65" →	Total distribution ☐	← 1.25" → **Copy A For Internal Revenue Service Center**
PAYER'S federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	**File with Form 1096.** .25"
RECIPIENT'S name		5 Employee contributions /Designated Roth contributions or insurance premiums $ .40"	6 Net unrealized appreciation in employer's securities $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)		7 Distribution code(s) ← 1.00" → IRA/ SEP/ SIMPLE ☐	8 Other ← 1.00" → .40" $ ← 2.50" → %	
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions $	
	1st year of desig. Roth contrib.	10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution ← 1.10" → $ $
Account number (see instructions)		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form **1099-R** Cat. No. 14436Q Department of the Treasury — Internal Revenue Service

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1.00"

.45"

9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution $	OMB No. 1545-0119 **2007** Form **1099-R**	**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
		2a Taxable amount $		
		2b Taxable amount not determined ☐	Total distribution ☐	**Copy A For Internal Revenue Service Center**
PAYER'S federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	**File with Form 1096.**
RECIPIENT'S name		5 Employee contributions /Designated Roth contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)		7 Distribution code(s) IRA/ SEP/ SIMPLE ☐	8 Other $ %	
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions $	
	1st year of desig. Roth contrib.	10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
Account number (see instructions)		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form **1099-R** Cat. No. 14436Q Department of the Treasury — Internal Revenue Service

Exhibit T

7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing 1.40" 2 Gross proceeds $	OMB No. 1545-0997 **2007** Form **1099-S**	**Proceeds From Real Estate Transactions**
FILER'S federal identification number 1.70" / TRANSFEROR'S identification number 1.70"	3 Address or legal description (including city, state, and ZIP code) 2.80"		1.10" **Copy A For Internal Revenue Service Center**
TRANSFEROR'S name			**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration . ▶ ☐		
Account or escrow number (see instructions)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing 2 Gross proceeds $	OMB No. 1545-0997 **2007** Form **1099-S**	**Proceeds From Real Estate Transactions**
FILER'S federal identification number / TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)		**Copy A For Internal Revenue Service Center**
TRANSFEROR'S name			**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration . ▶ ☐		
Account or escrow number (see instructions)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing 2 Gross proceeds $	OMB No. 1545-0997 **2007** Form **1099-S**	**Proceeds From Real Estate Transactions**
FILER'S federal identification number / TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)		**Copy A For Internal Revenue Service Center**
TRANSFEROR'S name			**File with Form 1096.**
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration . ▶ ☐		
Account or escrow number (see instructions)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

Exhibit U

9494 ☐ VOID ☐ CORRECTED

TRUSTEE'S/PAYER'S name, street address, city, state, and ZIP code			OMB No. 1545-1517 **2007** Form **1099-SA**	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 HSA ☐ Archer MSA ☐ MA MSA ☐		
City, state, and ZIP code				
Account number (see instructions)				

Form **1099-SA** Cat. No. 38471D Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

TRUSTEE'S/PAYER'S name, street address, city, state, and ZIP code			OMB No. 1545-1517 **2007** Form **1099-SA**	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 HSA ☐ Archer MSA ☐ MA MSA ☐		
City, state, and ZIP code				
Account number (see instructions)				

Form **1099-SA** Cat. No. 38471D Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

TRUSTEE'S/PAYER'S name, street address, city, state, and ZIP code			OMB No. 1545-1517 **2007** Form **1099-SA**	**Distributions From an HSA, Archer MSA, or Medicare Advantage MSA**
PAYER'S federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess cont. $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 HSA ☐ Archer MSA ☐ MA MSA ☐		
City, state, and ZIP code				
Account number (see instructions)				

Form **1099-SA** Cat. No. 38471D Department of the Treasury - Internal Revenue Service

Exhibit V

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $ 2 Rollover contributions ← 1.40" → $	OMB No. 1545-0747 **2007** Form **5498**	**IRA Contribution Information**
TRUSTEE'S or ISSUER'S federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		5 Fair market value of account $	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☐ SEP ☐	SIMPLE ☐ Roth IRA ☐	
City, state, and ZIP code		8 SEP contributions $ ← 1.40" →	9 SIMPLE contributions $ ← 1.40" →	
Account number (see instructions)		10 Roth IRA contributions $	11 Check if RMD for 2008 ☐	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $ 2 Rollover contributions $	OMB No. 1545-0747 **2007** Form **5498**	**IRA Contribution Information**
TRUSTEE'S or ISSUER'S federal identification no	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		5 Fair market value of account $	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☐ SEP ☐	SIMPLE ☐ Roth IRA ☐	
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (see instructions)		10 Roth IRA contributions $	11 Check if RMD for 2008 ☐	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $ 2 Rollover contributions $	OMB No. 1545-0747 **2007** Form **5498**	**IRA Contribution Information**
TRUSTEE'S or ISSUER'S federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		5 Fair market value of account $	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☐ SEP ☐	SIMPLE ☐ Roth IRA ☐	
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (see instructions)		10 Roth IRA contributions $	11 Check if RMD for 2008 ☐	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

Exhibit W

7272 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code 3.40"	1 Coverdell ESA contributions $ 2 Rollover contributions $	OMB No. 1545-1815 2007 Form 5498-ESA	Coverdell ESA Contribution Information
TRUSTEE'S/ISSUER'S federal identification no. / BENEFICIARY'S social security number		1.40"	Copy A For Internal Revenue Service Center
BENEFICIARY'S name			File with Form 1096.
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

.45"

Form **5498-ESA** Cat. No. 34011J Department of the Treasury - Internal Revenue Service

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7272 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 Coverdell ESA contributions $ 2 Rollover contributions $	OMB No. 1545-1815 2007 Form 5498-ESA	Coverdell ESA Contribution Information
TRUSTEE'S/ISSUER'S federal identification no. / BENEFICIARY'S social security number			Copy A For Internal Revenue Service Center
BENEFICIARY'S name			File with Form 1096.
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

Form **5498-ESA** Cat. No. 34011J Department of the Treasury - Internal Revenue Service

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7272 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 Coverdell ESA contributions $ 2 Rollover contributions $	OMB No. 1545-1815 2007 Form 5498-ESA	Coverdell ESA Contribution Information
TRUSTEE'S/ISSUER'S federal identification no. / BENEFICIARY'S social security number			Copy A For Internal Revenue Service Center
BENEFICIARY'S name			File with Form 1096.
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code			
Account number (see instructions)			

Form **5498-ESA** Cat. No. 34011J Department of the Treasury - Internal Revenue Service

Exhibit X

2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code		1 Employee or self-employed person's Archer MSA contributions made in 2007 and 2008 for 2007 $ 2 Total contributions made in 2007 $	OMB No. 1545-1518 **2007** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2008 for 2007 $		**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.)		6 HSA ☐		
City, state, and ZIP code		Archer MSA ☐ MA MSA ☐		
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V Department of the Treasury - Internal Revenue Service

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2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code		1 Employee or self-employed person's Archer MSA contributions made in 2007 and 2008 for 2007 $ 2 Total contributions made in 2007 $	OMB No. 1545-1518 **2007** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2008 for 2007 $		**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.)		6 HSA ☐		
City, state, and ZIP code		Archer MSA ☐ MA MSA ☐		
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V Department of the Treasury - Internal Revenue Service

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2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code		1 Employee or self-employed person's Archer MSA contributions made in 2007 and 2008 for 2007 $ 2 Total contributions made in 2007 $	OMB No. 1545-1518 **2007** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2008 for 2007 $		**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.)		6 HSA ☐		
City, state, and ZIP code		Archer MSA ☐ MA MSA ☐		
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V Department of the Treasury - Internal Revenue Service

Exhibit Y

3232 ☐ CORRECTED

PAYER'S name Street address ← 3.00" → City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings ← 1.45" →	2 Federal income tax withheld ← 1.45" →	OMB No. 1545-0238 **2007** **Form W-2G** **Certain Gambling Winnings**
	3 Type of wager	4 Date won	
	5 Transaction	6 Race	
	7 Winnings from identical wagers	8 Cashier	← 1.40" →
WINNER'S name 2.85" Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	11 First I.D.	12 Second I.D.	
	13 State/Payer's state identification no.	14 State income tax withheld	**File with Form 1096.**
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

3232 ☐ CORRECTED

PAYER'S name Street address City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings	2 Federal income tax withheld	OMB No. 1545-0238 **2007** **Form W-2G** **Certain Gambling Winnings**
	3 Type of wager	4 Date won	
	5 Transaction	6 Race	
	7 Winnings from identical wagers	8 Cashier	
WINNER'S name Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	11 First I.D.	12 Second I.D.	
	13 State/Payer's state identification no.	14 State income tax withheld	**File with Form 1096.**
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

3232 ☐ CORRECTED

PAYER'S name Street address City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings	2 Federal income tax withheld	OMB No. 1545-0238 **2007** **Form W-2G** **Certain Gambling Winnings**
	3 Type of wager	4 Date won	
	5 Transaction	6 Race	
	7 Winnings from identical wagers	8 Cashier	
WINNER'S name Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window	For Privacy Act and Paperwork Reduction Act Notice, see the **2007 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	11 First I.D.	12 Second I.D.	
	13 State/Payer's state identification no.	14 State income tax withheld	**File with Form 1096.**
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

Exhibit Z

Form **1042-S**

Department of the Treasury
Internal Revenue Service

Foreign Person's U.S. Source Income Subject to Withholding

2007

OMB No. 1545-0096

Copy A for Internal Revenue Service

☐ AMENDED ☐ PRO-RATA BASIS REPORTING

1 Income code	2 Gross income	3 Withholding allowances	4 Net income	5 Tax rate	6 Exemption code	7 U.S. Federal tax withheld	8 Amount repaid to recipient

9 Withholding agent's EIN ▶ ☐ EIN ☐ QI-EIN

10a WITHHOLDING AGENT'S name

10b Address (number and street)

10c Additional address line (room or suite no.)

10d City or town, province or state, and country | 10e ZIP code or foreign postal code

11 Recipient's account number (optional) | 12 Recipient code

13a RECIPIENT'S name

13b Address (number and street)

13c Additional address line (room or suite no.)

13d City or town, province or state, and country | 13e ZIP code or foreign postal code

14 Recipient's U.S. TIN, if any ▶ ☐ SSN or ITIN ☐ EIN ☐ QI-EIN

15 Recipient's country of residence for tax purposes | 16 Country code

17 NONQUALIFIED INTERMEDIARY'S (NQI's)/ FLOW-THROUGH ENTITY'S name | 18 Country code

19a NQI's/Flow-through entity's address (number and street)

19b Additional address line (room or suite no.)

19c City or town, province or state, and country | 19d ZIP code or foreign postal code

20 NQI's/Flow-through entity's TIN, if any ▶

21 PAYER'S name and TIN (if different from withholding agent's)

22 State income tax withheld | 23 Payer's state tax no. | 24 Name of state

5.50"

3.75"

7.25"

For Privacy Act and Paperwork Reduction Act Notice, see page 16 of the separate instructions. Cat. No. 11386R Form **1042-S** (2007)

8.00"

Form **1042-S**

Department of the Treasury
Internal Revenue Service

Foreign Person's U.S. Source Income Subject to Withholding

2007

OMB No. 1545-0096

Copy A for Internal Revenue Service

☐ AMENDED ☐ PRO-RATA BASIS REPORTING

1 Income code	2 Gross income	3 Withholding allowances	4 Net income	5 Tax rate	6 Exemption code	7 U.S. Federal tax withheld	8 Amount repaid to recipient

9 Withholding agent's EIN ▶ ☐ EIN ☐ QI-EIN

10a WITHHOLDING AGENT'S name

10b Address (number and street)

10c Additional address line (room or suite no.)

10d City or town, province or state, and country | 10e ZIP code or foreign postal code

11 Recipient's account number (optional) | 12 Recipient code

13a RECIPIENT'S name

13b Address (number and street)

13c Additional address line (room or suite no.)

13d City or town, province or state, and country | 13e ZIP code or foreign postal code

14 Recipient's U.S. TIN, if any ▶ ☐ SSN or ITIN ☐ EIN ☐ QI-EIN

15 Recipient's country of residence for tax purposes | 16 Country code

17 NONQUALIFIED INTERMEDIARY'S (NQI's)/ FLOW-THROUGH ENTITY'S name | 18 Country code

19a NQI's/Flow-through entity's address (number and street)

19b Additional address line (room or suite no.)

19c City or town, province or state, and country | 19d ZIP code or foreign postal code

20 NQI's/Flow-through entity's TIN, if any ▶

21 PAYER'S name and TIN (if different from withholding agent's)

22 State income tax withheld | 23 Payer's state tax no. | 24 Name of state

For Privacy Act and Paperwork Reduction Act Notice, see page 16 of the separate instructions. Cat. No. 11386R Form **1042-S** (2007)

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also: Part I, Section 42; 1.42–13.)

Rev. Proc. 2007–54

SECTION 1. PURPOSE

This revenue procedure establishes a procedure for temporary relief from certain requirements of § 42 of the Internal Revenue Code for owners of low-income housing buildings (Owners) and housing credit agencies of States or possessions of the United States (Agencies) in major disaster areas declared by the President. This revenue procedure supersedes the relief provisions of Rev. Proc. 95–28, 1995–1 C.B. 704.

SECTION 2. CHANGE

.01 Under §1.42–13(a) of the Income Tax Regulations, the Secretary may provide guidance to carry out the purposes of § 42 through various publications in the Internal Revenue Bulletin. Rev. Proc. 95–28 provided a procedure for temporary relief from certain requirements under § 42 in major disaster areas. Sections 5 and 6 of Rev. Proc. 95–28 provided certain relief from the carryover allocation provisions under 42(h)(1)(E) and § 1.42–6. The carryover allocation provisions were later amended by section 135(a)(1) of the Community Renewal Tax Relief Act of 2000 (Public Law 106–554) to allow a building that receives an allocation of credit in the second half of a calendar year to qualify for the carryover allocation of credit if the taxpayer expends an amount equal to 10 percent or more of the taxpayer's reasonably expected basis in the building within six months of receiving the allocation. In addition, § 1.42–6 was modified under T.D. 9110, 2004–1 C.B. 504, on December 31, 2003, to reflect the amendments to § 42(h)(1)(E). This revenue procedure makes changes to the provisions of Rev. Proc. 95–28 to extend temporary relief in major disaster areas to the carryover allocation provisions taking into account the amendments to § 42 and changes to the regulations.

.02 Section 8 of Rev. Proc. 95–28 provided certain relief to Agency compliance monitoring requirements under § 1.42–5. Several provisions of § 1.42–5 were subsequently modified under T.D. 8859, 2000–1 C.B. 429, on January 13, 2000. This revenue procedure incorporates the modified compliance monitoring requirements under T.D. 8859.

.03 The Internal Revenue Service (Service) has issued several notices suspending certain § 42 requirements for Owners that provide temporary housing to individuals residing in certain major disaster areas who have been displaced because their residences have been destroyed or damaged as a result of the disaster. See Notice 2004–74, 2004–2 C.B. 875; Notice 2004–75, 2004–2 C.B. 876; and Notice 2004–76, 2004–2 C.B. 878; Notice 2005–69, 2005–2 C.B. 622; and Notice 2006–11, 2006–1 C.B. 457. This revenue procedure provides a procedure for Owners to rent on a temporary basis vacant low-income units to certain displaced low-income individuals that resided in major disaster areas described in section 4 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to Agencies and Owners in major disaster areas, as defined in section 4 of this revenue procedure.

SECTION 4. MAJOR DISASTER AREA

When a disaster occurs that warrants assistance from the federal government, the Robert T. Stafford Disaster Relief and Emergency Assistance Act (the Stafford Act), Title 42 U.S.C. 5121–5206 (2000 and Supp. IV 2004) authorizes the President to issue a major disaster declaration for the affected area. When the President issues such a declaration, the Federal Emergency Management Agency (FEMA) publishes a notice in the Federal Register designating particular cities and/or counties or other local jurisdictions covered by the President's major disaster declaration as eligible for Individual Assistance and/or Public Assistance. A city and/or county or other local jurisdiction so designated by FEMA for Individual Assistance and/or Public Assistance under the President's disaster declaration is a major disaster area for purposes of the relief provisions under sections 5, 6, 7, 8, 9, 10, and 12 of this revenue procedure. The emergency housing relief of section 11 of this revenue procedure applies only in States or possessions where FEMA designates cities and/or counties or other local jurisdictions for Individual Assistance.

SECTION 5. RELIEF FOR CARRYOVER ALLOCATIONS

.01 A carryover allocation is an allocation of low-income housing credits made in a year before the project is placed in service.

.02 If an Owner has a carryover allocation for a building located in a major disaster area, the Service will treat the Owner as having satisfied the 10-percent basis requirement of § 42(h)(1)(E)(ii) if the Owner incurs more than 10 percent of the Owner's reasonably expected basis in the project (land and depreciable basis) no later than six months after the date that Owners would otherwise be required to meet the 10-percent basis requirement under § 1.42–6(a)(2)(i) and (ii). See § 1.42–6 for specific rules on carryover allocations.

.03 If an Owner has a carryover allocation for a building located in a major disaster area and the area is declared a major disaster area during the 2-year period described in § 42(h)(1)(E)(i), the Service will treat the Owner as having satisfied the applicable placed in service requirement if the Owner places the building in service no later than December 31 of the year following the end of the 2-year period. See § 1.42–6 for specific rules on carryover allocations.

.04 If an Owner obtains the relief provided in section 5.02 of this revenue procedure but fails to satisfy the 10-percent basis requirement of § 42(h)(1)(E)(ii) by the extension period granted under the authority of section 5.02, the Service will treat the carryover allocation under § 1.42–6(a)(2)(i)(ii) as a credit returned to the Agency on the day following the end of the extension period granted under the authority of section 5.02, provided the Agency complies with the requirements of § 1.42–14(d)(3). See § 1.42–14 for specific rules on returned credits.

.05 If an Owner obtains the relief provided in section 5.03 of this revenue procedure but fails to satisfy the placed in service requirement of § 42(h)(1)(E)(i) by the close of the calendar year following the end of the 2-year period of

§ 42(h)(1)(E)(i), the Service will treat the carryover allocation credit amount as a credit returned to the Agency on January 1 of the second year following the two year period of § 42(h)(1)(E)(i), provided the Agency complies with the requirements of § 1.42–14(d)(3).

SECTION 6. PROCEDURE TO OBTAIN CARRYOVER ALLOCATION RELIEF

.01 An Owner may obtain the carryover allocation relief described in sections 5.02 or 5.03 of this revenue procedure only if the Owner receives approval for the relief from the Agency that issued the carryover allocation.

.02 The Agency may approve the carryover allocation relief provided in sections 5.02 and 5.03 of this revenue procedure only for projects whose Owners cannot reasonably satisfy the deadlines of § 42(h)(1)(E) because of a disaster that led to a major disaster declaration under the Stafford Act. An Agency may make this determination on an individual project basis or may determine, because of the extent of the damage in a major disaster area that all Owners or a certain group of Owners in the major disaster area warrant the relief provided in sections 5.02 and 5.03 of this revenue procedure. An Agency has the discretion to provide less than the full amount of relief allowed under sections 5.02 and 5.03 or no relief based upon all the facts and circumstances.

.03 An Agency that chooses to approve the relief provided in sections 5.02 and 5.03 of this revenue procedure must do so before filing the Form 8610, *Annual Low-Income Housing Credit Agencies Report*, that covers the preceding calendar year. The Form 8610 is due by February 28 of the year following the year to which the Form 8610 applies.

.04 An Agency that provides the relief in sections 5.02 and 5.03 of this revenue procedure must report to the Service projects granted relief by attaching the required documentation as provided in the instructions to Form 8610. The Agency should identify only those buildings, including buildings granted relief in January and February of the year in which the Agency files the Form 8610, that had received its approval of the carryover allocation relief provided in sections 5.02 and 5.03 of this revenue procedure since the Agency last filed the Form 8610.

SECTION 7. RECAPTURE RELIEF

.01 Under § 42(j)(4)(E), a building (1) that is beyond the first year of the credit period and (2) that, because of a disaster that led to a major disaster declaration, has suffered a reduction in qualified basis that would cause it to be subject to recapture or loss of credit will not be subject to recapture or loss of credit if the building's qualified basis is restored within a reasonable restoration period. The Agency that monitors the building for compliance with § 42 shall determine what constitutes a reasonable restoration period, not to exceed 24 months after the end of the calendar year in which the President issued a major disaster declaration for the area where the building is located. If the Owner of the building fails to restore the building within the reasonable restoration period determined by the Agency, the Owner shall lose all credit claimed during the restoration period and suffer recapture for any prior years of claimed credit under the provisions of § 42(j)(1).

.02 To determine the credit amount allowable during the reasonable restoration period, an Owner described in section 7.01 of this revenue procedure must use the building's qualified basis at the end of the taxable year that preceded the President's major disaster declaration.

.03 Section 1.42–5(c)(1) requires an Owner to report any reduction in qualified basis to the Agency that monitors the building for compliance with § 42 whether or not an Owner obtains the relief provided in section 7.01 of this revenue procedure.

.04 As part of its review procedure adopted under § 1.42–5(c)(2), an Agency must determine whether the Owner described in section 7.01 of this revenue procedure has restored the building's qualified basis by the end of the reasonable restoration period established by the Agency. The Agency must report on Form 8823, *Low-Income Housing Credit Agencies Report of Noncompliance or Building Disposition*, any failure to restore qualified basis within such period.

SECTION 8. COMPLIANCE MONITORING RELIEF

.01 An Agency may extend the due date for its scheduled compliance reviews for up to one calendar year from the date the building is restored and placed back into service under section 7.01 of this revenue procedure.

.02 The granting of compliance monitoring relief to an Agency does not extend the compliance monitoring deadlines for Owners in major disaster areas. If an Agency discovers that an Owner has failed to comply with the rules of § 42 because of a major disaster, the Agency must report on the Form 8823 how the major disaster contributed to the noncompliance.

SECTION 9. BUILDINGS IN THE FIRST YEAR OF THE CREDIT PERIOD

.01 For buildings in the first year of the credit period that are located in a major disaster area and are severely damaged or destroyed as a result of a major disaster, an Agency has the discretion to treat the allocation as returned credit to the Agency in accordance with the requirements of § 1.42–14(d)(3), or may toll the beginning of the first year of the credit period under § 42(f)(1) until the project is restored. The tolling time period shall not extend more than 24 months after the end of the calendar year in which the President declared the area a major disaster area under the Stafford Act. No qualified basis shall be established until the building is restored and no low-income housing credit shall be claimed during the restoration period of such first-year buildings.

.02 An Agency that provides the relief in section 9.01 of this revenue procedure must report to the Service those projects granted relief by attaching the required documentation as provided in the instructions to Form 8610.

SECTION 10. AMOUNT OF CREDIT ALLOWABLE TO RESTORED BUILDING

.01 Except as provided in section 10.02 of this revenue procedure, in the case of a building for which a credit is allowed under § 42, no additional credit is permitted under § 42 for costs to restore, by recon-

struction or replacement, the building to its pre-casualty condition under § 42(j)(4)(E).

.02 An Agency may allocate credits for rehabilitation expenditures, as defined under § 42(e), that are in excess of the eligible basis immediately prior to the casualty. For this purpose, the eligible basis immediately prior to the casualty includes the original eligible basis and any subsequent rehabilitation expenditures treated as a separate new building under § 42(e).

SECTION 11. EMERGENCY HOUSING RELIEF

.01 *Approval of Housing Credit Agency*. Without prior authorization from the Service, an Agency may permit some or all Owners within the Agency's jurisdiction to provide temporary emergency housing after a major disaster to displaced low-income individuals that were living within the Agency's jurisdiction at the time of the major disaster. Prior to housing any displaced low-income individuals, the Owner must obtain written approval from the Agency to participate in temporary emergency housing relief. For this purpose, temporary emergency housing means housing displaced low-income individuals for a period not to exceed 4 months beyond the date of the President's major disaster declaration. An individual is a displaced individual if the individual was displaced from his/her principal place of residence as a result of a major disaster and the principal place of residence is in a city, county, or other local jurisdiction designated for Individual Assistance by FEMA as a result of the major disaster.

.02 *Requirements for Owner*. The temporary housing of displaced low-income individuals in low-income units without meeting the documentation requirements of § 1.42–5(b)(1)(vii) will not cause the building to suffer a reduction in qualified basis that would cause the recapture of low-income housing credits, provided the owner ensures the following requirements are met:

(1) *Temporary Self-Certification of Income Requirements*. An Owner may rely on a displaced low-income individual's self-certification of income eligibility signed under penalties of perjury in applying for temporary tenancy in the building as a result of a major disaster declaration as defined in section 4 of this revenue procedure. The self-certification shall provide that such individual's income will not exceed the applicable income limits of § 42 at the beginning of the individual's tenancy. The self-certification shall not extend for more than 4 months beyond the date of the President's major disaster declaration. The self-certification may be relied on by the Owner for purposes of determining the building's qualified basis under § 42(c)(1), and for purposes of satisfying the project's 20–50 or 40–60 minimum set-aside requirement as elected by the Owner under § 42(g)(1). During the 4-month self-certification period, the self-certified tenant is deemed a qualified tenant. After the 4-month self-certification period, the Owner must obtain all required documentation required under § 42 to support the tenant's continued status as a qualified low-income individual.

(2) *Self-Certification of Status as Displaced Individual*. An owner may rely on an individual's certification signed under penalties of perjury that the individual was displaced from his/her principal place of residence as a result of a major disaster and the principal place of residence is in a city, county, or other local jurisdiction designated for Individual Assistance as a result of the major disaster.

(3) *Recordkeeping*. To comply with the requirements of § 1.42–5, Owners must maintain and certify certain information concerning each displaced low-income individual temporarily housed in the project, specifically: name, address of damaged residence, social security number, the temporary self-certification of income, and the self-certification of status as a displaced individual. The Owner must also maintain and report to the Agency at the end of the emergency housing period a list of the names of the displaced individuals, and the dates the displaced individuals began and ceased temporary occupancy. This information shall be provided to the Service upon request.

(4) *Rent Restrictions*. Rents for the low-income units housing displaced individuals must not exceed the existing rent-restricted rates for the low-income units established under § 42(g)(2).

(5) *Protection of Existing Tenants*. Existing tenants in occupied low-income units cannot be evicted or have their tenancy terminated as a result of efforts to provide temporary housing for displaced individuals.

(6) *Suspension of Non-Transient Requirements*. The non-transient use requirement of § 42(i)(3)(B)(i) shall not apply to any unit providing temporary housing to a displaced individual during the 4-month temporary emergency housing period described in this section 11 of this revenue procedure.

SECTION 12. OTHER RELIEF

Under the authority granted in § 42(n) and in accordance with § 1.42–13(a), the Service will consider granting relief similar to that described in sections 5.02, 5.03, 7.01, or section 11 of this revenue procedure for situations that are brought to its attention and not covered by this revenue procedure.

SECTION 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 95–28, 1995–1 C.B. 704, is superseded.

SECTION 14. EFFECTIVE DATE

This revenue procedure is effective for a major disaster declaration issued by the President under the Stafford Act on or after July 2, 2007.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jack Malgeri of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Malgeri at (202) 622–3040 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Built-in Gains and Losses Under Section 382(h)

REG–144540–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rule making by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9330) that apply to corporations that have undergone ownership changes within the meaning of section 382. These regulations provide guidance on the treatment of prepaid income under the built-in gain provisions of section 382(h). The text of the temporary regulations published in this issue of the Bulletin serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by September 12, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–144540–06), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–144540–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC; or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–144540–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Keith Stanley, (202) 622–7750; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, at (202) 622–2949 (TDD Telephone) (not toll-free numbers) and his Email address is *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 382 of the Code. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. These regulations only apply in the rare circumstance in which a qualifying loss corporation that uses a particular accounting method undergoes an ownership change. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Nevertheless, the IRS and Treasury Department request comments from small entities that believe they might be adversely affected by these regulations. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Please see the "Comments" section of the temporary regulation on this subject for a description of specific issues on which comments are requested. The IRS and Treasury Department also request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Sean McKeever, Office of Associate Chief Counsel (Corporate).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.382–7 is also issued under 26 U.S.C. 382(m). * * *

Par. 2. Section 1.382–7 is added to read as follows:

§1.382–7 Built-in gains and losses.

[The text of this proposed section is the same as the text of §1.382–7T(a) through (b)(1) published elsewhere in this issue of the Bulletin].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 14, 2007, 72 F.R. 32828)

Section 1221(a)(4) Capital Asset Exclusion for Accounts and Notes Receivable; Hearing

Announcement 2007–66

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of public hearing on proposed rulemaking.

SUMMARY: This document provides a notice of a hearing on the proposed regulations (REG–109367–06, 2006–41 I.R.B. 683) under section 1221(a)(4) of the Internal Revenue Code.

DATES: The hearing will be held on Wednesday, August, 22, 2007 at 10:00 a.m.

ADDRESSES: The public hearing is being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, K. Scott Brown (202) 622–7454; to notify the IRS that you plan to attend the hearing and to be placed on the building access list, Kelly Banks at (202) 622–0392 (not toll-free numbers).

SUPPLEMENTARY INFORMATION: On August 7, 2006, the Treasury Department and the IRS published in the Federal Register (71 FR 44600) proposed regulations § 1.1221–1(e), under section 1221(a)(4) of the Internal Revenue Code. These regulations clarify the circumstances in which accounts or notes receivable are "acquired … for services rendered" within the meaning of section 1221(a)(4). A public hearing was held on November 7, 2006, to discuss these regulations. Only two individuals spoke at the hearing.

Additional written comments were received from interested parties after the period for comments closed and the hearing was held. Several of these written comments contained requests for private meetings. Because it is more appropriate to address the concerns raised in the comments publicly, the Treasury Department and the IRS are scheduling a public hearing at which taxpayers will have another opportunity to discuss the proposed regulations. The views expressed at the hearing will be used in the rulemaking process.

Most of the written comments focused on the length of time that the decisions have been outstanding in *Burbank Liquidating Corp. v. Commissioner*, 39 T.C. 999 (1963), *acq. sub. nom. United Assocs., Inc.*, 1965–1 C.B. 3, *aff'd in part and rev'd in part on other grounds*, 335 F.2d 125 (9th Cir. 1964), and *Federal National Mortgage Association v. Commissioner*, 100 T.C. 541 (1993). The Treasury Department and the IRS request participants at the forthcoming public hearing to focus on whether the interpretation in the proposed regulations is legally correct, and whether the decisions in *Burbank Liquidating* and *Federal National Mortgage Association* correctly applied section 1221(a)(4).

To attend the hearing, taxpayers must notify the IRS by Monday, July 23, 2007. Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 30 minutes before the hearing. To notify the IRS that you plan to attend the hearing and for information about having your name placed on the building access list to attend the hearing, see the section in this document entitled "FOR FURTHER INFORMATION CONTACT."

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on July 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 9, 2007, 72 F.R. 37155)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Proposed regulations provide rules relating to the valuation for income inclusion purposes of the entertainment use of business aircraft by specified individuals. See REG-147171-05, page 334.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 302.—Distributions in Redemption of Stock

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 331.—Gain or Loss to Shareholders in Corporate Liquidations

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 332.—Complete Liquidations of Subsidiaries

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 351.—Transfer to Corporation Controlled by Transferor

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 368.—Definitions Relating to Corporate Reorganizations

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 381.—Carryovers in Certain Corporate Acquisitions

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 408.—Individual Retirement Accounts

26 CFR 1.408–2: Individual retirement accounts.

T.D. 9331

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Deemed IRAs in Governmental Plans/Qualified Nonbank Trustee Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 408 of the Internal Revenue Code. The final regulations provide special rules for a governmental unit which seeks to qualify as a nonbank trustee of a deemed IRA that is part of its qualified employer plan. These final regulations affect only such governmental units.

DATES: *Effective Date:* June 18, 2007.

Applicability Date: For dates of applicability, see §1.408–2(e)(8)(iv).

FOR FURTHER INFORMATION CONTACT: Linda L. Conway, 202–622–6090, or Cathy A. Vohs, 202–622–6090 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains final amendments to the Income Tax Regulations (26 CFR Part 1) under section 408 of the Internal Revenue Code of 1986 (Code). On July 22, 2004, temporary and proposed regulations under section 408 were issued. A notice of proposed rulemaking (REG–101447–04, 2004–2 C.B. 344) was published in the **Federal Register** (69 FR 43786). The text of the temporary regulations also served as the text of the proposed regulations. The text of temporary §1.408–2(e)(8) was published in the same issue of the **Federal Register** (T.D. 9142, 2004–2 C.B. 302 [69 FR 43735]). The RIN published in connection with that notice of proposed rulemaking was 1545–BD07. However, due to technical difficulties that RIN is no longer valid and the RIN number of these final regulations is 1545–BG46. No comments were received regarding the proposed regulations.

Explanation of Provisions and Summary of Comments

These final regulations amend §1.408–2(e) of the regulations to provide that a governmental unit may serve as the trustee of any deemed IRA established by that governmental unit as part of its qualified employer plan if that governmental unit establishes to the satisfaction of the Commissioner that the manner in which it will administer the deemed IRA will be consistent with the requirements of section 408. These final regulations also provide special rules regarding the application of §1.408–2(e) to governmental units. These final regulations are adopted without substantive change from the proposed and temporary regulations. These final regulations are applicable for written applications made on or after June 18, 2007. The rules in this section also may be relied on for applications submitted on or after August 1, 2003 (or such earlier application as the Commissioner deems appropriate) and before June 18, 2007.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Linda L. Conway of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.408–2 (e)(8) is revised to read as follows:

§1.408–2 Individual retirement accounts.

* * * * *

(e) * * *

(8) *Special rules for governmental units*—(i) *In general.* A governmental unit that seeks to qualify as a nonbank trustee of a deemed IRA that is part of its qualified employer plan must demonstrate to the satisfaction of the Commissioner that it is able to administer the trust in a manner that is consistent with the requirements of section 408. The demonstration must be made by written application to the Commissioner. Notwithstanding the requirement of paragraph (e)(1) of this section that a person must demonstrate by written application that the requirements of paragraphs (e)(2) through (e)(6) of this section will be met in order to qualify as a nonbank trustee, a governmental unit that maintains a plan qualified under section 401(a), 403(a), 403(b) or 457 need not demonstrate that all of these requirements will be met with respect to any individual retirement accounts maintained by that governmental unit pursuant to section 408(q). For example, a governmental unit need not demonstrate that it satisfies the net worth requirements of paragraph (e)(3)(ii) of this section if it demonstrates instead that it possesses taxing authority under applicable law. The Commissioner, in his discretion, may exempt a governmental unit from certain other requirements upon a showing that the governmental unit is able to administer the deemed IRAs in the best interest of the participants. Moreover, in determining whether a governmental unit satisfies the other requirements of paragraphs (e)(2) through (e)(6) of this section, the Commissioner may apply the requirements in a manner that is consistent with the applicant's status as a governmental unit.

(ii) *Governmental unit.* For purposes of this special rule, the term *governmental unit* means a state, political subdivision of a state, and any agency or instrumentality of a state or political subdivision of a state.

(iii) *Additional rules.* The Commissioner may in revenue rulings, notices, or other guidance of general applicability provide additional rules for governmental units seeking approval as nonbank trustees.

(iv) *Effective/Applicability date.* This section is applicable for written applications made on or after June 18, 2007. The rules in this section also may be relied on for applications submitted on or after August 1, 2003 (or such earlier application as the Commissioner deems appropriate) and before June 18, 2007.

§1.408–2T [Removed]

Par. 3. Section 1.408–2T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 15, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 18, 2007, 72 F.R. 33387)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 883.—Exclusions From Gross Income

26 CFR 1.883–1: Exclusion of income from the international operation of ships or aircraft.

T.D. 9332

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Exclusions From Gross Income of Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations under section 883(a) and (c) of the Internal Revenue Code (Code), relating to the exclusion from gross income of income derived by certain foreign corporations engaged in the international operation of ships or aircraft. These regulations revise §1.883–3 of the final regulations, relating to the eligibility of controlled foreign corporations for the exclusion under section 883, following the repeal of section 954(a)(4) and (f) (foreign base company shipping provisions) by section 415 of the American Jobs Creation Act of 2004. In addition, these regulations provide certain additional guidance under section 883(a) and (c), including for foreign corporations that are organized in countries providing an exemption from taxation for certain shipping and air transport income solely through an income tax convention. The text of these temporary regulations also serves as the text of the proposed regulations (REG–138707–06) set forth in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on June 25, 2007.

Applicability Date: For dates of applicability, see §1.883–5T.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, at (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations has been reviewed, and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1667. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

For further information concerning these collections of information, where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

1. *Section 883 and the Final Regulations*

Sections 883(a)(1) and (a)(2) of the Code generally provide that income from the international operation of ships or aircraft derived by a foreign corporation will be excluded from gross income and exempt from U.S. taxation if the foreign country in which the corporation is organized grants an equivalent exemption to corporations organized in the United States. Section 883(c)(1) provides that a foreign corporation cannot qualify for the section 883(a) exemption if 50 percent or more of the value of its stock is owned by individuals who are not residents of a country that grants an equivalent exemption to U.S. corporations. However, under section 883(c)(2), section 883(c)(1) does not apply to a foreign corporation that is a controlled foreign corporation as defined in section 957(a) (CFC). In addition, under section 883(c)(3), section 883(c)(1) does not apply to a foreign corporation whose stock is primarily and regularly traded on an established securities market in the United States or in a foreign country that grants an equivalent exemption to U.S. corporations.

On August 26, 2003, the IRS and the Treasury Department issued final regulations under section 883 in T.D. 9087, 2003–2 C.B. 781 [68 FR 51394]. The final regulations provide, in general, that a foreign corporation organized in a qualified foreign country and engaged in the international operation of ships or aircraft may exclude qualified income from gross income for purposes of U.S. Federal income taxation provided that the corporation can satisfy certain ownership and related substantiation and reporting requirements. A foreign corporation that meets these requirements is a "qualified foreign corporation." A foreign country that grants U.S. corporations an equivalent exemption from gross income is a "qualified foreign country." The final regulations also provide definitions of the terms "qualified income" and "equivalent exemption." In addition, the final regulations specify how a foreign corporation can satisfy the ownership and related substantiation and reporting requirements, and the information that the foreign corporation must include on its U.S. income tax return in order to claim an exemption.

In general, a foreign corporation must own or lease an entire ship or aircraft, and the ship or aircraft must carry cargo or passengers for hire, in order for the foreign corporation to be engaged in the operation of a ship or aircraft for this purpose. Section 1.883–1(e). Section 1.883–1(f) provides rules for determining whether income is derived from the international operation of a ship or aircraft. Section 1.883–1(g)(1) provides rules for determining whether certain activities of a foreign corporation that is engaged in the international operation of ships or aircraft are so closely related to that operation as to be considered incidental to the international operation of ships or aircraft. The final regulations provide a nonexclusive list of activities that are considered incidental to the international operation of ships or aircraft. Income from these incidental activities is deemed to be income derived from the international operation of a ship or aircraft for purposes of the exclusion under section 883. Section 1.883–1(g)(2) also provides a nonexclusive list of activities that are not incidental to the international operation of ships or aircraft. The final regulations reserve on whether services, including ground services, maintenance, catering, and other services, are considered incidental to the international operation of ships or aircraft.

Section 1.883–1(h) provides that an equivalent exemption may exist if a foreign country generally imposes no tax on income or specifically provides a domestic tax law exemption for income derived from the international operation of ships or aircraft. Alternatively, a foreign country may exchange a diplomatic note, or enter into an agreement, with the United States that provides for a reciprocal exemption for purposes of section 883. Section 1.883–1(h)(3)(i) generally provides that a foreign country that grants an exemption from taxation for income from the international operation of ships or aircraft solely through an income tax convention with the United States is not considered to grant an equivalent exemption. Thus, a corporation organized in such a country may not claim an exclusion under section 883, and can only claim available treaty benefits to exempt income derived from international transport.

The final regulations require that a foreign corporation must satisfy one of three stock ownership tests to satisfy the ownership requirements of section 883(c): a publicly-traded test in §1.883–2(a), a CFC stock ownership test in §1.883–3(a), or a qualified shareholder stock ownership test in §1.883–4(a). Under §1.883–3(a), a foreign corporation satisfies the CFC stock ownership test if it meets an "income inclusion test" and satisfies certain substantiation and reporting requirements under §1.883–3(c) and (d). The income inclusion test requires that more than 50 percent of the CFC's adjusted net foreign base company income (as defined in §1.954–1(d) and as increased or decreased by section 952(c)) derived from the international operation of ships or aircraft be includible in the gross income of one or more U.S. citizens, individual residents of the United States, or domestic corporations. Section 1.883–3(b). This rule prevents individuals residing in foreign countries that do not grant an equivalent exemption to U.S. corporations from benefiting from the section 883 exemption by owning a CFC through a domestic partnership, estate or trust.

Section 1.883–4 of the final regulations provides rules for when a foreign corporation satisfies the qualified shareholder stock ownership test. To satisfy this test, qualified shareholders must own (applying the attribution rules of §1.883–4(c)) more than 50 percent of the value of a foreign corporation's outstanding shares for half the number of days in the corporation's taxable year. The foreign corporation must also meet the substantiation and reporting requirements of §1.883–4(d) and (e). Under the reporting requirements of §1.883–4(e), a foreign corporation must attach a statement with certain information to its Form 1120–F, "*U.S. Income Tax Return of a Foreign Corporation*," including the names and addresses of individual shareholders with large shareholdings (at least 5 percent) in the foreign corporation.

2. *Elimination of Foreign Base Company Shipping Income*

Section 415 of the American Jobs Creation Act of 2004 (Public Law 108–357 (118 Stat. 1418) (AJCA) repealed section 954(a)(4) and (f), eliminating foreign base company shipping income as a type of foreign base company income, and there-

fore, as subpart F income. The repeal is effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of United States shareholders with or within which such taxable years of foreign corporations end. Section 423 of AJCA also delayed the applicability date of the final regulations under section 883(a) and (c) for one year, until taxable years beginning after September 24, 2004.

Commentators noted that the repeal of the foreign base company shipping provisions created uncertainty about the application of the income inclusion test for CFCs that no longer have foreign base company income.

On August 5, 2005, the IRS and the Treasury Department issued T.D. 9218, 2005–2 C.B. 503 [70 FR 45529], to conform the applicability date of the final regulations in light of section 423 of AJCA. The preamble to T.D. 9218 also acknowledged commentators' concerns regarding the application of the income inclusion test after the repeal of the foreign base company shipping provisions. The preamble stated that a CFC that satisfied the income inclusion test prior to the effective date of section 415 of AJCA would continue to satisfy that test after the effective date of the legislation, provided the CFC is able to demonstrate that if the foreign base company shipping provisions had not been repealed, more than 50 percent of the its current earnings and profits derived from the international operation of ships or aircraft would have been attributable to amounts includible in the gross income of one or more U.S. citizens, individual residents of the United States, or domestic corporations (pursuant to section 951(a)(1)(A) or another provision of the Code) for the taxable years of such persons in which the taxable year of the CFC ends.

The preamble to T.D. 9218 also stated that the IRS and the Treasury Department would issue regulations to clarify the application of the income inclusion test, and invited further comments on the most appropriate way to accomplish a clarification consistent with the principles of the existing section 883 regulations, and the repeal of the foreign base company shipping provisions.

3. *Issuance of Notice 2006–43*

The IRS and the Treasury Department received a number of comments in response to the preamble language in T.D. 9218 dealing with the income inclusion test. Generally, commentators stated that to require CFCs to calculate hypothetical amounts of subpart F income as though the foreign base company shipping provisions had not been repealed was too complex an approach to administer properly. Commentators proposed several alternative approaches they viewed as simpler to the approach described in T.D. 9218.

After considering these comments, the IRS and the Treasury Department issued Notice 2006–43, "Interim Guidance With Respect to the Application of Treas. Reg. §1.883–3," (2006–1 C.B. 921 (May 22, 2006)), which announced a new approach. Under the notice, a CFC would satisfy the stock ownership test of §1.883–1(c)(2) if it met a "qualified U.S. person ownership test" and satisfied revised substantiation and reporting requirements. To satisfy the qualified U.S. person ownership test, a corporation would be required to be a CFC for more than half the days of its taxable year, and more than 50 percent of the total value of the CFC's outstanding stock would have to be owned (within the meaning of section 958(a) as modified by the notice) by one or more qualified U.S. persons for more than half the days of its taxable year. See §601.601(d)(2).

These temporary regulations incorporate the rules of Notice 2006–43, with certain amendments, and respond to comments that have been received concerning other portions of the existing section 883 regulations.

4. *Additional Comments*

The following additional comments were received regarding the final regulations.

A. *Ground services*

The final regulations reserved on whether the performance of a variety of ground services should be treated as activities that are incidental to the international operation of ships or aircraft. Section 1.883–1(g)(3). The IRS and the Treasury Department have received a number of comments from the air transport industry requesting guidance under section 883 on the treatment of ground services, including cargo handling, maintenance services, catering, and customer service. Commentators have pointed to recent changes in the Commentaries to Article 8 (Shipping, Inland Waterways Transport and Air Transport) of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Co-operation and Development (the OECD Model Convention) that clarify the circumstances under which certain services performed by an enterprise engaged in the operation of ships or aircraft in international traffic may be either ancillary or directly related to such operations, and thereby covered services for purposes of Article 8 of the OECD Model Convention.

B. *U.S. income tax conventions as equivalent exemptions*

Commentators have also suggested that countries that provide an exemption to U.S. corporations only through an income tax convention with the United States should be treated as granting an equivalent exemption for purposes of section 883. In support of their position, commentators cite the Senate Committee Report to the Tax Reform Act of 1986 (Public Law 99–514 (100 Stat. 2085)), which states:

> The committee intends that a country which, as a result of a treaty with the United States, exempts U.S. citizens and domestic corporations from tax in the country on income derived from the operation of ships or aircraft, has an equivalent exemption, even though the treaty technically contains certain additional requirements other than residence, such as U.S. registration or documentation of the ship or aircraft.

(S. Rep. No. 99–313, at 343–44 (1986))

Prior to 2001, a foreign country that provided an exemption from taxation for income from the international operation of ships or aircraft through an income tax convention was treated as granting an equivalent exemption for purposes of section 883. See Rev. Rul. 89–42, 1989–1 C.B. 234; Rev. Rul. 97–31, 1997–2 C.B. 77 (supplementing Rev. Rul. 89–42). In 2001, however, the IRS and the Treasury Department reconsidered this position, and concluded that an exemption under an

income tax convention could not constitute an equivalent exemption for purposes of section 883(a) because the Code and income tax conventions have different eligibility requirements, and provide exemptions that vary in scope. See Rev. Rul. 2001–48, 2001–2 C.B. 324 (modifying and superseding Rev. Rul. 97–31). The position taken in Rev. Rul. 2001–48 was incorporated into §1.883–1(h)(3)(i) of the final regulations. See §601.601(d)(2).

C. *Reporting requirements related to qualified shareholder stock ownership test*

In connection with the substantiation and reporting requirements for the qualified shareholder stock ownership test under §1.883–4(a), the IRS and the Treasury Department have continued to receive comments expressing concern over the requirement that the names and addresses of individual shareholders with large shareholdings (at least 5 percent) in corporations relying on this ownership test be disclosed on Form 1120–F. Recent comments have suggested that in lieu of providing such names and addresses, taxpayers should be permitted to submit a sworn statement by a U.S. tax practitioner subject to Circular 230 with their return that states that the taxpayer satisfies the qualified shareholder stock ownership test, and that the names and addresses of shareholders with large shareholdings are available for inspection by the IRS at the office of that such practitioner.

Explanation of Provisions

These temporary regulations incorporate the rules of Notice 2006–43 and also address a number of comments that have been received concerning other portions of the existing section 883 regulations.

1. *Modifications to the Income Inclusion Test*

These temporary regulations generally adopt the qualified U.S. person ownership test contained in Notice 2006–43. A CFC meets the qualified U.S. person ownership test in §1.883–3T(b)(1) only if more than 50 percent of the total value of all the outstanding stock of the CFC is owned (within the meaning of section 958(a), as modified in §1.883–3T(b)(4)), by one or more qualified U.S. persons. The term *qualified U.S. person* means a U.S. citizen, resident alien, domestic corporation, or domestic trust described in section 501(a). For purposes of applying the qualified U.S. person ownership test, the value of the stock of the CFC that is owned (directly or indirectly) through bearer shares is not taken into account in the numerator, but is taken into account in the denominator to determine the portion of the overall stock value that is owned by qualified U.S. persons. Section 1.883–3T(b)(3).

For purposes of applying the qualified U.S. person ownership test, the attribution rules of section 958(a) will apply to determine the ownership interests of qualified U.S. persons held through foreign entities. In addition, the temporary regulations extend the attribution rules of section 958(a) to domestic partnerships, domestic trusts not described in section 501(a), and domestic estates. In the case of these domestic entities, stock will be treated as owned proportionately by the partners, beneficiaries, grantors, or other interest holders in such entities, respectively, applying the rules of section 958(a) as if the domestic partnership, estate, or trust were a foreign partnership, estate, or trust, respectively. The regulations also contain conforming changes to the substantiation and reporting provisions in this section to reflect the new qualified U.S. person ownership test for CFCs. A CFC that fails this test will not be a qualified foreign corporation unless it meets either the publicly-traded test of §1.883–2(a) or the qualified shareholder stock ownership test of §1.883–4(a).

2. *Activities Incidental to the International Operation of Ships or Aircraft*

The IRS and the Treasury Department recognize that guidance is needed on the extent to which ground services that are conducted by foreign corporations engaged in the international operation of ships or aircraft are so closely related to such operation that they are considered activities incidental to the international operation of ships or aircraft. Section 1.883–1T(g)(1)(xi) treats the provision of goods and services by engineers, ground and equipment maintenance staff, cargo handlers, catering staff, and customer services personnel, and the provision of facilities such as passenger lounges, counter space, ground handling equipment, and hanger facilities as activities incidental to the international operation of a ship or aircraft. The regulations also make clear that such services will be treated as incidental, whether provided to another enterprise as part of a pooling arrangement, alliance, or other joint venture.

3. *Countries Providing an Exemption Only Through an Income Tax Convention*

In response to comments and further study, the IRS and the Treasury Department believe that it is appropriate to provide additional guidance on when a country that only provides for an exemption by means of an income tax convention with the United States will be considered as granting an equivalent exemption for purposes of section 883(a). Section 1.883–1(h)(1), which sets forth the various bases on which equivalent exemptions may be claimed, is broadened by §1.883–1T(h)(1)(ii) to include a domestic tax law exemption by income tax convention. Section 1.883–1T(h)(3) sets out the conditions under which an exemption under an income tax convention may constitute an equivalent exemption.

If a foreign country provides an exemption from tax under a shipping and air transport or gains article of an income tax convention with the United States, and it does not otherwise provide an equivalent exemption through a diplomatic note, domestic statutory law, or by generally not imposing income tax on foreign corporations engaged in the international operation of ships or aircraft, a corporation organized in that country may treat that income tax convention as providing an equivalent exemption for purposes of section 883, but only if the foreign corporation meets all the conditions for claiming benefits with respect to such income under the income tax convention, and the category of income for which the convention grants benefits is also described in §1.883–1(h)(2).

For example, if a foreign corporation is seeking an exemption with respect to non-incidental container-related income, it may not treat an exemption provided by an income tax convention for that type of income as an equivalent exemption, because that category of income is not listed in §1.883–1(h)(2). Equivalent exemptions are determined separately with respect to each category of income listed

in §1.883–1(h)(2). As a result, the foreign corporation may treat an exemption under an income tax convention with respect to another category of income that is listed in §1.883–1(h)(2) (for example, incidental bareboat charter income) as an equivalent exemption for purposes of section 883.

A foreign corporation that is entitled to treat an income tax convention as providing an equivalent exemption with respect to a particular category of income under §1.883–1T(h)(1)(ii) will not always qualify for an exclusion from gross income under section 883. For example, a corporation that is a resident of a foreign country for purposes of an income tax convention because that is where it is managed and controlled is not a qualified foreign corporation under §1.883–1(c)(1), and may not claim an exclusion from gross income under section 883, if it is not also organized in that country. Similarly, a foreign corporation that does not meet one of the stock ownership tests described in §1.883–1(c)(2) is not a qualified foreign corporation under §1.883–1(c)(1), and may not claim an exclusion from gross income under section 883, even though it would satisfy the limitation on benefits article under the relevant convention.

4. *Countries that Provide an Exemption Through an Income Tax Convention and by Other Means*

As provided in the final regulations, a foreign corporation that qualifies for an exemption from tax under an income tax convention and an equivalent exemption under section 883 through a diplomatic note, domestic statutory law, or by generally imposing no income tax on foreign corporations engaged in the international operation of ships or aircraft will continue to have the choice of whether to claim an exemption under the income tax convention or under section 883. Section 1.883–1T(h)(3)(ii)(A). If a foreign corporation chooses to claim an exemption under an income tax convention, it may also choose to claim an exemption under section 883 for any category of income listed in §1.883–1(h)(2), to the extent that such income is also exempt under an income tax convention. Section 1.883–1T(h)(3)(ii)(B).

The rules provided in §1.883–1(h)(3)(iii) of the final regulations for certain joint ventures also continue in modified form. A foreign corporation resident in a country that only provides an exemption through an income tax convention with the United States, and that participates in a joint venture entity that is fiscally transparent for U.S. tax purposes but not under the law of the treaty jurisdiction, will not be able to take advantage of the new rules on equivalent exemptions under income tax conventions, and must rely on §1.883–1T(h)(3)(iii).

5. *Reporting Requirements Related to Qualified Shareholder Stock Ownership Test*

Upon further study and review, the IRS and the Treasury Department have decided to bring the disclosure required under each of the stock ownership tests provided in §1.883–1(c)(2) into greater accord with the disclosure required for comparable stock ownership tests with similar tax policy objectives. For example, reporting in conjunction with the stock ownership tests found in the branch profits tax regulations and limitation on benefits articles in U.S. income tax conventions does not require the disclosure of certain shareholder names and addresses to the IRS. See §1.884–5 and Form 8833, "*Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).*" Consequently, these regulations have eliminated the requirement that the names and addresses of shareholders in corporations relying on the various stock ownership tests in §1.883–1(c)(1) (that is, under the closely held exception to the publicly-traded test, the CFC stock ownership test, and the qualified shareholder stock ownership test) be disclosed on Form 1120–F. See §§1.883–2T(e), 1.883–3T(c), and 1.883–4T(d).

Foreign corporations will continue to have to report on Form 1120–F certain summary information regarding the shareholdings that are relied upon to satisfy the applicable stock ownership test (for example, aggregate percentage of interests held by shareholders by country of residence). Under new §1.883–1T(c)(3)(i)(G), they also will have to report whether any shareholder whose stock holdings are relied upon to meet an ownership test holds such stock either directly or indirectly through bearer shares. In addition, each qualified shareholder and intermediary (if any) must declare under penalties of perjury that its ownership interest in the foreign corporation or any corporate intermediary is not held through bearer shares. Conforming amendments to the substantiation and documentation requirements in §§1.883–2T(e) and 1.883–4T(d)(4) have been made.

Commentators suggested alternative methods for making the names and addresses of 5-percent shareholders available to the IRS. However, these methods were not adopted due to the complexity of the regimes proposed, and questions as to whether such approaches would in fact address the commentators' concerns. Instead, the IRS and the Treasury Department chose to rely on procedures already in place in §1.883–1(c)(3) and as modified by §1.883–1T(c)(3), which requires, among other things, that a foreign corporation obtain ownership statements to document and substantiate all representations it has made on Form 1120–F, and that it provide substantiating documentation in response to a written request from the Commissioner. Such information must be provided to the IRS within 30 days (rather than the 60 days allowed by §1.883–1(c)(3)) of a written request by the Commissioner, because the names and addresses of relevant shareholders will no longer be provided on the Form 1120–F by taxpayers. See §1.883–1T(c)(3).

The IRS and the Treasury Department believe that these revised reporting rules will simultaneously reduce disclosure concerns raised by taxpayers and encourage greater reporting of the information the IRS needs to administer section 883. The IRS and the Treasury Department also believe these changes, in conjunction with the remaining reporting requirements in §§1.883–2(f), 1.883–2T(f), 1.883–3T(d), 1.883–4(e), and 1.883–4T(e), will provide sufficient information to ensure the sound and efficient administration of section 883.

Effective Dates

See §1.883–5T(d) for effective date of these temporary regulations and §1.883–5T(e) for applicability dates that apply to these temporary regulations.

Effect on Other Documents

The following publications are modified as of June 25, 2007:

Notice 2006–43, 2006–1 C.B. 921 (May 22, 2006).

Rev. Rul. 2001–48, 2001–2 C.B. 324.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Patricia A. Bray of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.883–0 is amended by:

1. Revising the entries for §1.883–1(g)(3) and (h)(3).

2. Revising the entry for §1.883–2(e)(2).

3. Revising the entries for §1.883–3.

4. Adding the entries for §1.883–5(d) and (e).

The revisions and additions read as follows:

§1.883–0 Outline of major topics.

* * * * *

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(g) * * *

(3) [Reserved]. For further guidance, see the entry for §1.883–1T(g)(3).

* * * * *

(h) * * *

(3) [Reserved]. For further guidance, see the entries for §1.883–1T(h)(3).

* * * * *

§1.883–2 Treatment of publicly-traded corporations.

* * * * *

(e)(2) [Reserved]. For further guidance, see the entry for §1.883–2T(e)(2).

* * * * *

§1.883–3 Treatment of controlled foreign corporations.

[Reserved]. For further guidance, see the entry for §1.883–3T.

* * * * *

§1.883–5 Effective/applicability dates.

* * * * *

(d) [Reserved]. For further guidance, see the entry for §1.883–5T(d).

(e) [Reserved]. For further guidance, see the entry for §1.883–5T(e).

Par. 3. Section 1.883–0T is added to read as follows:

§1.883–0T Outline of major topics (temporary).

This section lists the major paragraphs contained in §§1.883–1T through 1.883–5T.

§1.883–1T Exclusion of income from the international operation of ships or aircraft (temporary).

(a) through (c)(3)(i) [Reserved]. For further guidance, see entries for §1.883–1(a) through (c)(3)(i).

(ii) Further documentation.

(A) General rule.

(B) Names and addresses of certain shareholders.

(c)(4) through (g)(2) [Reserved]. For further guidance, see entries for §1.883–1(c)(4) through (g)(2).

(3) Other services. [Reserved].

(g)(4) through (h)(2) [Reserved]. For further guidance, see entries for §1.883–1(g)(4) through (h)(2).

(3) Special rules with respect to income tax conventions.

(i) Countries with only an income tax convention.

(ii) Countries with both an income tax convention and an equivalent exemption.

(A) General rule.

(B) Special rule for simultaneous benefits under section 883 and an income tax convention.

(iii) Participation in certain joint ventures.

(iv) Independent interpretation of income tax conventions.

(h)(4) through (j) [Reserved]. For further guidance, see entries for §1.883–1(h)(4) through (j).

§1.883–2T Treatment of publicly-traded corporations (temporary).

(a) through (e)(1) [Reserved]. For further guidance, see entries for §1.883–2(a) through (e)(1).

(2) Availability and retention of documents for inspection.

(f) [Reserved]. For further guidance, see entry for §1.883–2(f).

§1.883–3T Treatment of controlled foreign corporations (temporary).

(a) General rule.

(b) Qualified U.S. person ownership test.

(1) General rule.

(2) Qualified U.S. person.

(3) Treatment of bearer shares.

(4) Attribution of ownership through certain domestic entities.

(5) Examples.

(c) Substantiation of CFC stock ownership.

(1) In general.

(2) Ownership statements from qualified U.S. persons.

(3) Ownership statements from intermediaries.

(4) Three-year period of validity.

(5) Availability and retention of documents for inspection.

(d) Reporting requirements.

§1.883–5T Effective/applicability dates (temporary).

(a) through (c) [Reserved]. For further guidance, see entries for §1.883–5(a) through (c).

(d) Effective date.

(e) Applicability dates.

(f) Expiration date.

Par. 4. Section 1.883–1 is amended by:

1. Revising paragraphs (c)(3)(i)(D), (c)(3)(ii), (g)(1)(ix), (g)(1)(x), (g)(3), (h)(1)(ii), and (h)(3).

2. Revising paragraphs (c)(3)(i)(G) and (c)(3)(i)(H).

3. Adding new paragraph (c)(3)(i)(I).

4. Adding paragraph (g)(1)(xi).

5. Revising paragraph (g)(3).

The revisions and additions read as follows:

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(D) [Reserved]. For further guidance, see §1.883–1T(c)(3)(i)(D).

* * * * *

(G) through (I) [Reserved]. For further guidance, see §1.883–1T(c)(3)(i)(G) through (I).

(ii) [Reserved]. For further guidance, see §1.883–1T(c)(3)(ii).

* * * * *

(g) * * *

(1) * * *

(ix) through (xi) [Reserved]. For further guidance, see §1.883–1T(g)(1)(ix) through (xi).

(2) * * *

(3) [Reserved]. For further guidance, see §1.883–1T(g)(3).

* * * * *

(h) * * *

(1) * * *

(ii) [Reserved]. For further guidance, see §1.883–1T(h)(1)(ii).

* * * * *

(3) [Reserved]. For further guidance, see §1.883–1T(h)(3).

* * * * *

Par. 5. Section 1.883–1T is added to read as follows:

§1.883–1T Exclusion of income from the international operation of ships or aircraft (temporary).

(a) through (c)(3)(i)(C) [Reserved]. For further guidance, see §1.883–1(a) through (c)(3)(i)(C).

(D) The applicable authority for an equivalent exemption, for example, the citation of a statute in the country where the corporation is organized, a diplomatic note between the United States and such country, or an income tax convention between the United States and such country in the case of a corporation described in paragraphs (h)(3)(i) through (iii) of this section;

(c)(3)(i)(E) through (F) [Reserved]. For further guidance, see §1.883–1(c)(3)(i)(E) through (F).

(G) A statement that none of the foreign corporation's shares or shares of any intermediary entity, if any, that are held by qualified shareholders and relied on to satisfy any of the stock ownership tests described in §1.883–1(c)(2) are issued in bearer form;

(H) Any other information required under §1.883–2(f), §1.883–2T(f), §1.883–3T(d), §1.883–4(e), or §1.883–4T(e), as applicable; and

(I) Any other relevant information specified in Form 1120–F, "*U.S. Income Tax Return of a Foreign Corporation*," and its accompanying instructions.

(ii) *Further documentation*—(A) *General rule*. Except as provided in this paragraph (c)(3)(ii)(B), if the Commissioner requests in writing that the foreign corporation document or substantiate representations made under paragraph (c)(3)(i) of this section, or under §1.883–2(f), §1.883–2T(f), §1.883–3T(d), §1.883–4(e), or §1.883–4T(e), as applicable, the foreign corporation must provide the documentation or substantiation within 60 days following the written request. If the foreign corporation does not provide the documentation and substantiation requested within the 60-day period, but demonstrates that the failure was due to reasonable cause and not willful neglect, the Commissioner may grant the foreign corporation a 30-day extension. Whether a failure to obtain the documentation or substantiation in a timely manner was due to reasonable cause and not willful neglect shall be determined by the Commissioner after considering all the facts and circumstances.

(B) *Names and addresses of certain shareholders*. If the Commissioner requests the names and permanent addresses of individual qualified shareholders of a foreign corporation, as represented on each such individual's ownership statement, to substantiate the requirements of the exception to the closely-held test in the publicly-traded test in §1.883–2(e), the qualified shareholder stock ownership test in §1.883–4(a), or the qualified U.S. person ownership test in §1.883–3T(b), the foreign corporation must provide the documentation and substantiation within 30 days following the written request. If the foreign corporation does not provide the documentation and substantiation within the 30-day period, but demonstrates that the failure was due to reasonable cause and not willful neglect, the Commissioner may grant the foreign corporation a 30-day extension. Whether a failure to obtain the documentation or substantiation in a timely manner was due to reasonable cause and not willful neglect shall be determined by the Commissioner after considering all the facts and circumstances.

(c)(4) through (g)(1)(viii) [Reserved]. For further guidance, see §1.883–1(c)(4) through (g)(1)(viii).

(ix) Arranging by means of a space or slot charter for the carriage of cargo listed on a bill of lading or airway bill or similar document issued by the foreign corporation on the ship or aircraft of another corporation engaged in the international operation of ships or aircraft;

(x) The provision of containers and related equipment by the foreign corporation in connection with the international carriage of cargo for use by its customers, including short-term use within the United States immediately preceding or following the international carriage of cargo (and for this purpose, a period of five days or less shall be presumed to be short-term); and

(xi) The provision of goods and services by engineers, ground and equipment maintenance staff, cargo handlers, catering staff, and customer services personnel, and

the provision of facilities such as passenger lounges, counter space, ground handling equipment, and hanger facilities.

(2) [Reserved]. For further guidance, see §1.883–1(g)(2).

(3) *Other services*. [Reserved].

(g)(4) through (h)(1)(i) [Reserved]. For further guidance, see §1.883–1(g)(4) through (h)(1)(i).

(ii) Specifically provides a domestic law tax exemption for income derived from the international operation of ships or aircraft, either by statute, decree, income tax convention, or otherwise; or

(h)(1)(iii) and (h)(2) [Reserved]. For further guidance, see §1.883–1(h)(1)(iii) and (h)(2).

(3) *Special rules with respect to income tax conventions*—(i) *Countries with only an income tax convention.* If a foreign country only provides an exemption from tax for profits from the operation of ships or aircraft in international transport or international traffic under the shipping and air transport or gains article of an income tax convention with the United States, a foreign corporation organized in that country may treat that exemption as an equivalent exemption for purposes of section 883, but only if—

(A) The foreign corporation meets all the conditions for claiming benefits with respect to such profits under the income tax convention; and

(B) The profits that are exempt pursuant to the income tax convention also fall within a category of income described in paragraphs (h)(2)(i) through (viii) of this section.

(ii) *Countries with both an income tax convention and an equivalent exemption*—(A) *General rule.* If a foreign country provides an exemption from tax for profits from the operation of ships or aircraft in international transport or international traffic under the shipping and air transport or gains article of an income tax convention, and that foreign country also provides an equivalent exemption under section 883 by some other means for one or more categories of income under paragraph (h)(2) of this section, the foreign corporation may choose annually whether to claim an exemption under section 883 or the income tax convention. Except as provided in this paragraph (h)(3)(ii)(B), any such choice will apply with respect to all categories of qualified income of the foreign corporation and cannot be made separately with respect to different categories of income. If a foreign corporation bases its claim for an exemption on section 883, it must satisfy all of the requirements of this section to qualify for an exemption from U.S. income tax. If the foreign corporation bases its claim for an exemption on an income tax convention, it must satisfy all of the requirements for claiming benefits under the income tax convention. See §1.883–4(b)(3) for rules about satisfying the stock ownership test of §1.883–1(c)(2) using shareholders resident in a foreign country that offers an exemption under an income tax convention.

(B) *Special rule for simultaneous benefits under section 883 and an income tax convention.* If a foreign corporation is organized in a foreign country that offers an exemption from tax under an income tax convention and also by some other means, such as by diplomatic note or domestic statutory law, with respect to the same category of income, and the foreign corporation chooses to claim an exemption under an income tax convention under paragraph (h)(3)(ii)(A) of this section, it may simultaneously claim an exemption under section 883 with respect to a category of income exempt from tax by such other means if it satisfies the requirements of paragraphs (h)(3)(i)(A) and (B) of this section for each category of income, satisfies one of the stock ownership tests of paragraph (c)(2) of this section, and complies with the substantiation and reporting requirements in paragraph (c)(3) of this section.

(iii) *Participation in certain joint ventures.* A foreign corporation resident in a foreign country that provides an exemption only through an income tax convention will not be precluded from treating that exemption as an equivalent exemption if it derives income through a participation, directly or indirectly, in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement, or other joint venture described in §1.883–1(e)(2), and the foreign corporation would be ineligible to claim benefits under the convention for that category of income solely because the joint venture was not fiscally transparent, within the meaning of §1.894–1(d)(3)(iii)(A), with respect to that category of income under the income tax laws of the foreign corporation's country of residence.

(iv) *Independent interpretation of income tax conventions.* Nothing in §§1.883–1 through 1.883–5, or in this section and §§1.883–2T through1.883–5T, affects the rights or obligations under any income tax convention. The definitions provided in §§1.883–1 through 1.883–5, or in this section and §§1.883–2T through 1.883–5T, shall not give meaning to similar terms used in any income tax convention, or provide guidance regarding the scope of any exemption provided by such convention, unless the income tax convention entered into force after August 26, 2003, and it, or its legislative history, explicitly refers to section 883 and guidance promulgated under that section for its meaning.

1. Par. 6. Section 1.883–2 is amended by revising paragraphs (e)(2), (f)(3), and (f)(4)(ii) to read as follows:

§1.883–2 Treatment of publicly-traded corporations.

* * * * *

(e) * * *

(2) [Reserved]. For further guidance, see §1.883–2T(e)(2).

(f) * * *

(3) [Reserved]. For further guidance, see §1.883–2T(f)(3).

(4) * * *

(ii) [Reserved]. For further guidance, see §1.883–2T(f)(4)(ii).

* * * * *

Par. 7. Section 1.883–2T is added to read as follows:

§1.883–2T Treatment of publicly-traded corporations (temporary).

(a) through (e)(1) [Reserved]. For further guidance, see §1.883–2(a) through (e)(1).

(2) *Availability and retention of documents for inspection.* The documentation described in §1.883–2(e)(1) must be retained by the corporation seeking qualified foreign corporation status until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such time and such place as the Commissioner

may request in writing in accordance with §1.883–1T(c)(3)(ii)(A) or (B), as applicable.

(f) through (f)(2) [Reserved]. For further guidance, see §1.883–2(f) through (f)(2).

(3) A description of each class of stock relied upon to meet the requirements of §1.883–2(d), including whether the class of stock is issued in registered or bearer form, the number of issued and outstanding shares in that class of stock as of the close of the taxable year, and the value of each class of stock in relation to the total value of all the corporation's shares outstanding as of the close of the taxable year;

(4) and (4)(i) [Reserved]. For further guidance, see §1.883–2(f)(4) and (f)(4)(i).

(ii) With respect to all qualified shareholders who own directly, or by application of the attribution rules in §1.883–4(c), stock in the closely-held block of stock upon which the corporation intends to rely to satisfy the exception to the closely-held test of §1.883–2(d)(3)(ii)—

(A) The total number of qualified shareholders, as defined in §1.883–4(b)(1);

(B) The total percentage of the value of the shares owned, directly or indirectly, by such qualified shareholders by country of residence, determined under §1.883–4(b)(2) (residence of individual shareholders) or §1.883–4(d)(3) (special rules for residence of certain shareholders); and

(C) The days during the taxable year of the corporation that such qualified shareholders owned, directly or indirectly, their shares in the closely held block of stock.

(5) [Reserved]. For further guidance, see §1.883–2(f)(5).

Par. 8. Section 1.883–3 is revised to read as follows:

§1.883–3 Treatment of controlled foreign corporations.

[Reserved]. For further guidance, see §1.883–3T.

Par. 9. Section 1.883–3T is added to read as follows:

§1.883–3T Treatment of controlled foreign corporations (temporary).

(a) *General rule.* A foreign corporation satisfies the stock ownership test of §1.883–1(c)(2) if it is a controlled foreign corporation (as defined in section 957(a)), satisfies the qualified U.S. person ownership test in paragraph (b) of this section, and satisfies the substantiation and reporting requirements of paragraphs (c) and (d) of this section, respectively. A CFC that fails the qualified U.S. person ownership test of paragraph (b) of this section will not satisfy the stock ownership test of §1.883–1(c)(2) unless it meets either the publicly-traded test of §1.883–2(a) or the qualified shareholder stock ownership test of §1.883–4(a).

(b) *Qualified U.S. person ownership test*—(1) *General rule.* A foreign corporation will satisfy the requirements of the qualified U.S. person ownership test only if it—

(i) Is a CFC for more that half the days in the corporation's taxable year; and

(ii) More than 50 percent of the total value of its outstanding stock is owned (within the meaning of section 958(a) and paragraph (b)(4) of this section) by one or more qualified U.S. persons for more than half the days of the CFC's taxable year, provided such days of ownership are concurrent with the time period during which the foreign corporation satisfies the requirement in paragraph (b)(1)(i) of this section.

(2) *Qualified U.S. person.* For purposes of this section, the term *qualified U.S. person* means a U.S. citizen, resident alien, domestic corporation, or domestic trust described in section 501(a), but only if the person provides the CFC with an ownership statement as described in paragraph (c)(2) of this section, and the CFC meets the reporting requirements of paragraph (d) of this section with respect to that person.

(3) *Treatment of bearer shares.* For purposes of applying the qualified U.S. person ownership test, the value of the stock of a CFC that is owned (directly or indirectly) through bearer shares by qualified U.S. persons is not taken into account in the numerator of the fraction, but is taken into account in the denominator to determine the portion of the value of stock owned by qualified U.S. persons.

(4) *Attribution of ownership through certain domestic entities.* For purposes of applying the qualified U.S. person ownership test of paragraph (b)(1) of this section, stock owned, directly or indirectly, by or for a domestic partnership, domestic trust not described in section 501(a), or domestic estate, shall be treated as owned proportionately by its partners, beneficiaries, grantors, or other interest holders, respectively, applying the rules of section 958(a) as if such domestic entity were a foreign entity. Stock considered to be owned by a person by reason of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

(5) *Examples.* The qualified U.S. person ownership test of paragraph (b)(1) of this section is illustrated in the following examples:

Example 1. Ship Co is a CFC for more than half the days of Ship Co's taxable year. Ship Co is organized in a qualified foreign country. All of its shares are owned by a domestic partnership for the entire taxable year. All of the partners in the domestic partnership are citizens and residents of foreign countries. Ship Co fails the qualified U.S. person ownership test of paragraph (b)(1) of this section because none of the value of Ship Co's stock is owned, applying the attribution rules of paragraph (b)(4) of this section, for at least half the number of days of Ship Co's taxable year, by one or more qualified U.S. persons. Therefore, Ship Co must satisfy the qualified shareholder stock ownership test of §1.883–4(a) in order to satisfy the stock ownership test of §1.883–1(c)(2), and be considered a qualified foreign corporation.

Example 2. Ship Co is a CFC for more than half the days of its taxable year. Ship Co is organized in a qualified foreign country. Corp A, a foreign corporation whose stock is owned by a citizen and resident of a foreign country, owns 40 percent of the value of the stock of Ship Co for the entire taxable year. X, a domestic partnership, owns the remaining 60 percent of the value of the stock of Ship Co for Ship Co's entire taxable year. X is owned by 20 partners, all of whom are U.S. citizens and each of whom has owned a 5-percent interest in X for the entire taxable year of Ship Co. Ship Co satisfies the qualified U.S. person ownership test of paragraph (b)(1) of this section because 60 percent of the value of the stock of Ship Co is owned, applying the attribution of ownership rules of paragraph (b)(4) of this section, for at least half the number of days of Ship Co's taxable year by the partners of X, who are all qualified U.S. persons as defined in paragraph (b)(2) of this section. If Ship Co satisfies the substantiation and reporting requirements of paragraphs (c) and (d) of this section, it will meet the stock ownership test of §1.883–1(c)(2).

Example 3. Ship Co is a foreign corporation organized in a qualified foreign country. Ship Co has two classes of stock, Class A representing 60 percent of the vote and value of all the shares outstanding of Ship Co, and Class B representing the remaining 40 percent of the vote and value of Ship Co. A, a U.S. citizen, holds for the entire taxable year all of the Class A stock, which is issued in bearer form, and B, a nonresident alien, owns all the Class B stock, which is in registered form. Ship Co cannot satisfy the qualified U.S. person ownership test of paragraph (b)(1) of this section because A's bearer shares cannot be taken into account as being owned by a qualified U.S. person in determining if the qualified U.S. person ownership test has been met; the shares are, however, taken

into account in determining the total value of Ship Co's outstanding shares.

(c) *Substantiation of CFC stock ownership*—(1) *In general*. A foreign corporation that relies on this CFC test to satisfy the stock ownership test of §1.883–1(c)(2) must establish all the facts necessary to demonstrate to the Commissioner that it satisfies the qualified U.S. person ownership test of paragraph (b)(1) of this section. Specifically, the CFC must obtain a written ownership statement, signed under penalties of perjury by an individual authorized to sign that person's Federal tax or information return, from—

(i) Each qualified U.S. person upon whose stock ownership it relies to meet this test; and

(ii) Each domestic intermediary described in paragraph (b)(4) of this section, each foreign intermediary (including a foreign corporation, partnership, trust, or estate), and mere legal owners or record holders acting as nominees standing in the chain of ownership between each such qualified U.S. person and the CFC, if any.

(2) *Ownership statements from qualified U.S. persons*. A qualified U.S. person ownership statement must contain the following information:

(i) The qualified U.S. person's name, permanent address, and taxpayer identification number.

(ii) If the qualified U.S. person owns shares directly in the CFC, the number of shares of each class of stock of the CFC owned by the qualified person, the period of time during the taxable year of the CFC when the person owned the stock, and a representation that its interest in the CFC is not held through bearer shares.

(iii) If the qualified person owns an indirect interest in the CFC through an intermediary described in paragraph (c)(1)(ii) of this section, the name of that intermediary, the amount and nature of the interest in the intermediary, the period of time during the taxable year of the CFC when the person held such interest, and, in the case of an interest in a foreign corporate intermediary, a representation that such interest is not held through bearer shares.

(iv) Any other information as specified in guidance published by the Internal Revenue Service (see §601.601(d)(2) of this chapter).

(3) *Ownership statements from intermediaries*. An intermediary ownership statement required of an intermediary described in paragraph (c)(1)(ii) of this section must contain the following information:

(i) The intermediary's name, permanent address, and taxpayer identification number, if any.

(ii) If the intermediary directly owns stock in the CFC, the number of shares of each class of stock of the CFC owned by the intermediary, the period of time during the taxable year of the CFC when the intermediary owned the stock, and a representation that such interest is not held through bearer shares.

(iii) If the intermediary indirectly owns the stock of the CFC, the name and address of each intermediary standing in the chain of ownership between it and the CFC, the period of time during the taxable year of the CFC when the intermediary owned the interest, the percentage of interest it holds indirectly in the CFC, and, in the case of a foreign corporate intermediary, a representation that its interest is not held through bearer shares.

(iv) Any other information as specified in guidance published by the Internal Revenue Service (see §601.601(d)(2) of this chapter).

(4) *Three-year period of validity*. The rules of §1.883–4(d)(2)(ii) apply for purposes of determining the validity of the ownership statements required under paragraph (c)(2) of this section.

(5) *Availability and retention of documents for inspection*. The documentation described in this paragraph (c) must be retained by the corporation seeking qualified foreign corporation status (the CFC) until the expiration of the statute of limitations for the taxable year of the CFC to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such place as the Commissioner may request in writing in accordance with §1.883–1T(c)(3)(ii).

(d) *Reporting requirements*. A foreign corporation that relies on the CFC test of this section to satisfy the stock ownership test of §1.883–1(c)(2) must provide the following information in addition to the information required by §1.883–1(c)(3) to be included in its Form 1120–F, "*U.S. Income Tax Return of a Foreign Corporation*," for the taxable year. The information must be based upon the documentation received by the foreign corporation pursuant to paragraph (c) of this section and must be current as of the end of the corporation's taxable year—

(1) The percentage of the value of the shares of the CFC that is owned by all qualified U.S. persons identified in paragraph (c)(2) of this section, applying the attribution of ownership rules of paragraph (b)(4) of this section;

(2) The period during which such qualified U.S. persons held such stock;

(3) The period during which the foreign corporation was a CFC;

(4) A statement that the CFC is directly held by qualified U.S. persons and does not have any bearer shares outstanding or, in the alternative, that it is not relying on direct or indirect ownership of such shares to meet the qualified U.S. person ownership test; and

(5) Any other relevant information specified by Form 1120–F, and its accompanying instructions, or in guidance published by the Internal Revenue Service (see §601.601(d)(2) of this chapter).

Par. 10. Section 1.883–4 is amended by:

1. Revising paragraphs (d)(4)(i)(C) and (d)(4)(i)(D).

2. Removing paragraph (e)(2).

3. Redesignating paragraphs (e)(3) and (e)(4) as paragraphs (e)(2) and (e)(3), respectively, and revising them.

The revisions read as follows:

§1.883–4 Qualified shareholder stock ownership test.

* * * * *

(d) * * *

(4) * * *

(i) * * *

(C) and (D) [Reserved]. For further guidance, see §1.883–4T(d)(4)(i)(C) and (D).

(e) * * *

(2) and (3) [Reserved]. For further guidance, see §1.883–4T(e)(2) and (3).

Par. 11. Section 1.883–4T is added to read as follows:

§1.883–4T Qualified shareholder stock ownership test (temporary).

(a) through (d)(4)(i)(B) [Reserved]. For further guidance, see §1.883–4(a) through (d)(4)(i)(B).

(C) If the individual directly owns stock in the corporation seeking qualified for-

eign corporation status, the name of the corporation, the number of shares in each class of stock of the corporation that are so owned, with a statement that such shares are not issued in bearer form, and the period of time during the taxable year of the foreign corporation when the individual owned the stock;

(D) If the individual directly owns an interest in a corporation, partnership, trust, estate, or other intermediary that directly or indirectly owns stock in the corporation seeking qualified foreign corporation status, the name of the intermediary, the number and class of shares or the amount and nature of the interest of the individual in such intermediary, and, in the case of a corporate intermediary, a statement that such shares are not held in bearer form, and the period of time during the taxable year of the foreign corporation seeking qualified foreign corporation status when the individual held such interest;

(d)(4)(i)(E) through (e)(1) [Reserved]. For further guidance, see §1.883–4(d)(4)(i)(E) through (e)(1).

(2) With respect to all qualified shareholders relied upon to satisfy the 50 percent ownership test of §1.883–4(a), the total number of such qualified shareholders as defined in §1.883–4(b)(1); the total percentage of the value of the outstanding shares owned, applying the attribution rules of §1.883–4(c), by such qualified shareholders by country of residence or organization, whichever is applicable; and the period during the taxable year of the foreign corporation that such stock was held by qualified shareholders; and

(3) Any other relevant information specified by the Form 1120–F, "*U.S. Income Tax Return of a Foreign Corporation*," and its accompanying instructions, or in guidance published by the Internal Revenue Service (see §601.601(d)(2) of this chapter).

Par. 12. Section 1.883–5 is amended by revising the heading and adding paragraphs (d) and (e) to read as follows:

§1.883–5 Effective/applicability dates.

* * * * *

(d) through (e) [Reserved]. For further guidance, see §1.883–5T(d) through (e).

Par. 13. Section 1.883–5T is added to read as follows:

§1.883–5T Effective/applicability dates (temporary).

(a) through (c) [Reserved]. For further guidance, see §1.883–5(a) through (c).

(d) *Effective date*. These regulations are effective on June 25, 2007.

(e) *Applicability dates*. Sections 1.883–1T, 1.883–2T, 1.883–3T, and 1.883–4T are applicable to taxable years of the foreign corporation beginning after June 25, 2007. Taxpayers may elect to apply §1.883–3T to any open taxable years of the foreign corporation beginning on or after December 31, 2004.

(f) *Expiration date*. The applicability of §§1.883–1T, 1.883–2T, 1.883–3T, and 1.883–4T expires on or before June 22, 2010.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 15. In §602.101, paragraph (b) is amended by adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
§1.883–1T	1545–1667
§1.883–2T	1545–1667
§1.883–3T	1545–1667
§1.883–4T	1545–1667
§1.883–5T	1545–1667
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 14, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 25, 2007, 72 F.R. 34600)

Section 1081.—Nonrecognition of Gain or Loss on Exchanges or Distributions in Obedience to Orders of S.E.C.

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 1221.—Capital Asset Defined

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2007.

Rev. Rul. 2007–50

This revenue ruling provides various prescribed rates for federal income tax purposes for August 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2007–50 TABLE 1

Applicable Federal Rates (AFR) for August 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	5.00%	4.94%	4.91%	4.89%
110% AFR	5.50%	5.43%	5.39%	5.37%
120% AFR	6.02%	5.93%	5.89%	5.86%
130% AFR	6.52%	6.42%	6.37%	6.34%
Mid-term				
AFR	5.09%	5.03%	5.00%	4.98%
110% AFR	5.61%	5.53%	5.49%	5.47%
120% AFR	6.13%	6.04%	6.00%	5.97%
130% AFR	6.65%	6.54%	6.49%	6.45%
150% AFR	7.69%	7.55%	7.48%	7.43%
175% AFR	8.99%	8.80%	8.71%	8.64%
Long-term				
AFR	5.31%	5.24%	5.21%	5.18%
110% AFR	5.84%	5.76%	5.72%	5.69%
120% AFR	6.39%	6.29%	6.24%	6.21%
130% AFR	6.93%	6.81%	6.75%	6.72%

REV. RUL. 2007–50 TABLE 2

Adjusted AFR for August 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.75%	3.72%	3.70%	3.69%
Mid-term adjusted AFR	3.97%	3.93%	3.91%	3.90%
Long-term adjusted AFR	4.50%	4.45%	4.43%	4.41%

REV. RUL. 2007–50 TABLE 3 Rates Under Section 382 for August 2007	
Adjusted federal long-term rate for the current month	4.50%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.50%

REV. RUL. 2007–50 TABLE 4 Appropriate Percentages Under Section 42(b)(2) for August 2007	
Appropriate percentage for the 70% present value low-income housing credit	8.21%
Appropriate percentage for the 30% present value low-income housing credit	3.52%

REV. RUL. 2007–50 TABLE 5 Rate Under Section 7520 for August 2007	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	6.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 1502.—Regulations

26 CFR 1.1502–13: Intercompany transactions.

T.D. 9329

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 301, and 602

Guidance Necessary to Facilitate Business Electronic Filing and Burden Reduction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that affect taxpayers filing Federal income tax returns. They simplify, clarify, or eliminate reporting burdens and also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. This document also makes conforming changes to certain current regulations.

DATES: *Effective Date:* These regulations are effective on June 14, 2007.

Applicability Date: For dates of applicability, see §§1.302–2(d), 1.302–4(h), 1.331–1(f), 1.332–6(e), 1.338–10(c), 1.351–3(f), 1.355–5(e), 1.368–3(e), 1.381(b)–1(e), 1.382–8(j)(4), 1.382–11(b), 1.1081–11(f), 1.1221–2(j), 1.1502–13(m), 1.1502–31(j), 1.1502–32(j), 1.1502–33(k), 1.1502–95(g), 1.1563–3(e) and 1.6012–2(k).

FOR FURTHER INFORMATION CONTACT: For all sections except §1.6012–2, Grid Glyer, (202) 622–7930; for §1.6012–2, William T. Sullivan (202) 622–7052 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2019.

The collection of information in these final regulations is in §§1.302–2, 1.302–4, 1.331–1, 1.332–6, 1.338–10, 1.351–3, 1.355–5, 1.368–3, 1.381(b)–1, 1.382–8, 1.382–11, 1.1081–11, 1.1221–2, 1.1502–13, 1.1502–31, 1.1502–32, 1.1502–33, 1.1502–95, 1.1563–3 and 1.6012–2. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of the fair market value of any property (including stock) received and the basis of any property (including stock) surrendered in the transaction described in such section.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On May 30, 2006, the IRS and Treasury Department published temporary regulations (T.D. 9264, 2006–1 C.B. 1150) under

26 CFR part 1 and 26 CFR part 602. See 71 FR 30591. The IRS and Treasury Department issued a notice of proposed rulemaking (REG–134317–05, 2006–1 C.B. 1184) cross-referencing those temporary regulations on the same day. See 71 FR 30640.

In general, the regulations simplify, clarify, or eliminate reporting burdens for corporations and shareholders for certain transactions, including distributions, exchanges and reorganizations. They also eliminate impediments to the electronic filing of statements that taxpayers, primarily large corporations that are members of consolidated or controlled groups, are required to include on their Federal income tax returns.

These regulations were part of a series of regulations published by the IRS and Treasury Department that are designed to eliminate impediments to the electronic filing of forms and statements that taxpayers are required to include on their Federal income tax returns. See, for example, T.D. 9300, 2007–2 I.R.B. 246 [71 FR 71040], and T.D. 9243, 2006–1 C.B. 475 [71 FR 4276].

Explanation of Provisions

Except as provided in the following paragraph, this Treasury decision adopts the proposed regulations with no substantive changes. In addition, this Treasury decision removes the corresponding temporary regulations.

This Treasury decision does not adopt the following proposed regulations: §1.1502–35(c)(4)(i), §1.1502–76(b)(2)(ii)(D) and §1.1563–1 (c)(2)(i) through (iii). These proposed regulations will be addressed as part of other guidance projects.

The IRS and Treasury Department received no written or electronic comments from the public in response to the notice of proposed rulemaking and no public hearing was requested or held. However, three questions were raised informally and are addressed in this preamble.

Sec. 1.302–2

The first question involves a reporting requirement under §1.302–2 (redemptions not taxable as dividends). Specifically, the question involved proposed §1.302–2(b)(2), which requires all "significant holders" receiving property from a corporation in exchange for the corporation's stock ("redemption exchanges") to include a brief information statement on their return. The statement sets forth certain information necessary to determine the proper treatment of the redemption exchange. Under proposed §1.302–2(b)(3)(i), a significant holder is any stockholder owning 5 percent or more of the stock of a publicly traded company and any stockholder owning 1 percent or more of the stock of a company that is not publicly traded.

The specific question raised was whether the statement is necessary in all redemption exchanges, whether the exchange is treated as a distribution that is essentially equivalent to a dividend or not. Under the proposed regulations, all redemption exchanges are subject to this reporting requirement. The IRS and Treasury Department determined that the simplified information to be provided in the statement is necessary for the identification and evaluation of redemptions that are essentially equivalent to dividends. Furthermore, the required information is information that taxpayers should already have or be prepared to produce. Finally, as noted in this preamble, the regulations limit any remaining burden by imposing the reporting requirement only on significant holders. For all these reasons, the IRS and Treasury Department have concluded that the requirement does not impose an unnecessary or inappropriate burden on taxpayers. Accordingly, the final regulations adopt the rule proposed in §1.302–2(b)(2) and do not limit the application of the reporting requirement.

Sec. 1.302–4

The second question involves a reporting requirement under §1.302–4 (termination of shareholder's interest). Specifically, the question involved the statement in proposed §1.302–4(a) regarding the waiver of family attribution. Under this section and section 302(c)(2), a redeeming shareholder can avoid being treated as receiving a dividend equivalent distribution by waiving the application of the family attribution rules of section 318(a)(1). Prior to the promulgation of §1.302–4T(a), §1.302–4(a)(1) provided that taxpayers were required to file family attribution waiver agreements and §1.302–4(a)(2) prescribed conditions under which a taxpayer that had failed to timely file the agreement could obtain an extension of time to file from the appropriate district director. Section 1.302–4T(a) removed the requirement that an agreement be filed as well as the instructions regarding late filing. Instead, that regulation provided that a statement must be filed and set forth the information that must be included. Section 1.302–4T(a) did not include instructions for late filers.

The specific question raised was whether the change affected taxpayers' ability to remedy late filing. The IRS and Treasury Department did not intend any change to taxpayers' ability to remedy late filing. However, the final regulations do not incorporate instructions for late filing because the statement required is a regulatory election and the late filing of all regulatory elections is addressed by §301.9100–1. Accordingly, such instructions are not necessary and could inadvertently imply that the general rules would not otherwise apply.

Sec. 1.6012–2

Finally, a question was also raised concerning the reporting requirements applicable to foreign insurance corporations electing under section 953(d) to be treated as domestic insurance corporations. Specifically, the question raised was whether such corporations have a reporting requirement.

Section 1.6012–2(c)(1)(i) requires that a domestic life insurance company file with its return a copy of its annual statement which shows the reserves used by the company in computing the taxable income reported on its return, and a copy of Schedule A (real estate) and of Schedule D (bonds and stocks), or any successor thereto, of such annual statement. Section 1.6012–2(c)(2) similarly requires that a domestic nonlife insurance company file with its return a copy of its annual statement, including the underwriting and investment exhibit (or any successor thereto), for the year covered by such return. Section 953(d) provides that a foreign insurance company that satisfies the requirements of section 953(d), including the making of an election under

section 953(d)(1)(D), shall be treated as a domestic corporation for purposes of the Internal Revenue Code. Thus, a foreign insurance company that elects under section 953(d) to be treated as a domestic corporation generally is required under §1.6012–2(c)(1) or (2), as appropriate, to file with its return a copy of its annual statement. Under §1.6012–2(c)(5), the term "annual statement" includes a *pro forma* annual statement if the insurance company is not required to file the NAIC annual statement.

Because the reporting requirements of electing corporations are addressed in the current regulations, the IRS and Treasury Department are not modifying the regulations to address this point further.

Special Analysis

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to §§1.302–2, 1.302–4, 1.331–1, 1.332–6, 1.351–3, 1.355–5, 1.368–3, 1.381(b)–1, 1.1081–11, 1.1563–3, and 1.6012–2. With respect to the collections of information in such sections, and with respect to §§1.338–10, 1.382–8, 1.382–11, 1.1221–2, 1.1502–13, 1.1502–31, 1.1502–32, 1.1502–33 and 1.1502–95, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect large corporations (which are members of either controlled or consolidated groups) and in the case of all corporations will substantially reduce or eliminate the existing reporting burden. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Grid Glyer, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.302–2T, 1.302–4T, 1.331–1T, 1.332–6T, 1.338–10T, 1.351–3T, 1.355–5T, 1.368–3T, 1.381(b)–1T, 1.382–8T, 1.382–11T, 1.1081–11T, 1.1221–2T, 1.1502–13T, 1.1502–31T, 1.1502–33T, 1.1502–95T, 1.1563–3T and 1.6012–2T to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.302–2 is amended by:

1. Adding headings to paragraphs (a), (b), (b)(1) and (c).
2. Revising paragraphs (b)(2) and (d).
3. Adding paragraphs (b)(3) and (b)(4).

The additions and revisions read as follows:

§1.302–2 Redemptions not taxable as dividends.

(a) *In general.* * * *

(b) *Redemption not essentially equivalent to a dividend*—(1) *In general.* * * *

(2) *Statement.* Unless §1.331–1(d) applies, every significant holder that transfers stock to the issuing corporation in exchange for property from such corporation must include on or with such holder's return for the taxable year of such exchange a statement entitled, "STATEMENT PURSUANT TO §1.302–2(b)(2) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT HOLDER OF THE STOCK OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF ISSUING CORPORATION]." If a significant holder is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(i) The fair market value and basis of the stock transferred by the significant holder to the issuing corporation; and

(ii) A description of the property received by the significant holder from the issuing corporation.

(3) *Definitions.* For purposes of this section:

(i) *Significant holder* means any person that, immediately before the exchange—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is publicly traded; or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is not publicly traded.

(ii) *Publicly traded stock* means stock that is listed on—

(A) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(B) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(iii) *Issuing corporation* means the corporation that issued the shares of stock, some or all of which were transferred by a significant holder to such corporation in the exchange described in paragraph (b)(2) of this section.

(4) *Cross reference.* See section 6043 of the Internal Revenue Code for requirements relating to a return by a liquidating corporation.

(c) *Basis adjustments.* * * *

(d) *Effective/applicability date.* Paragraphs (b)(2), (b)(3) and (b)(4) of this section apply to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraphs (b)(2), (b)(3) and (b)(4) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.302–2 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.302–2T [Removed]

Par. 3. Section 1.302–2T is removed.

Par. 4. Section 1.302–4 is amended by:

1. Revising paragraphs (a) and (h).

2. Adding headings to paragraphs (b), (c), (d), (e), (f), and (g) introductory text.

The additions and revisions read as follows:

§1.302–4 Termination of shareholder's interest.

(a) *Statement.* The agreement specified in section 302(c)(2)(A)(iii) shall be in the form of a statement entitled, "STATEMENT PURSUANT TO SECTION 302(c)(2)(A)(iii) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER OR RELATED PERSON, AS THE CASE MAY BE], A DISTRIBUTEE (OR RELATED PERSON) OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF DISTRIBUTING CORPORATION]." The distributee must include such statement on or with the distributee's first return for the taxable year in which the distribution described in section 302(b)(3) occurs. If the distributee is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The distributee must represent in the statement—

(1) THE DISTRIBUTEE (OR RELATED PERSON) HAS NOT ACQUIRED, OTHER THAN BY BEQUEST OR INHERITANCE, ANY INTEREST IN THE CORPORATION (AS DESCRIBED IN SECTION 302(c)(2)(A)(i)) SINCE THE DISTRIBUTION; and

(2) THE DISTRIBUTEE (OR RELATED PERSON) WILL NOTIFY THE INTERNAL REVENUE SERVICE OF ANY ACQUISITION, OTHER THAN BY BEQUEST OR INHERITANCE, OF SUCH AN INTEREST IN THE CORPORATION WITHIN 30 DAYS AFTER THE ACQUISITION, IF THE ACQUISITION OCCURS WITHIN 10 YEARS FROM THE DATE OF THE DISTRIBUTION.

(b) *Substantiation information.* * * *

(c) *Stock of parent, subsidiary or successor corporation redeemed.* * * *

(d) *Redeemed shareholder as creditor.* * * *

(e) *Acquisition of assets pursuant to creditor's rights.* * * *

(f) *Constructive ownership rules applicable.* * * *

(g) *Avoidance of Federal income tax.* * * *

(h) *Effective/applicability date.* Paragraph (a) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (a) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.302–4 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.302–4T [Removed]

Par. 5. Section 1.302–4T is removed.

Par. 6. Section 1.331–1 is amended by:

1. Adding headings to paragraphs (a), (b), (c) and (e).

2. Revising paragraphs (d) and (f).

The additions and revisions read as follows:

§1.331–1 Corporate liquidations.

(a) *In general.* * * *

(b) *Gain or loss.* * * *

(c) *Recharacterization.* * * *

(d) *Reporting requirement*—(1) *General rule.* Every significant holder that transfers stock to the issuing corporation in exchange for property from such corporation must include on or with such holder's return for the year of such exchange the statement described in paragraph (d)(2) of this section unless—

(i) The property is part of a distribution made pursuant to a corporate resolution reciting that the distribution is made in complete liquidation of the corporation; and

(ii) The issuing corporation is completely liquidated and dissolved within one year after the distribution.

(2) *Statement.* If required by paragraph (d)(1) of this section, a significant holder must include on or with such holder's return a statement entitled, "STATEMENT PURSUANT TO §1.331–1(d) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT HOLDER OF THE STOCK OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF ISSUING CORPORATION]." If a significant holder is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(i) The fair market value and basis of the stock transferred by the significant holder to the issuing corporation; and

(ii) A description of the property received by the significant holder from the issuing corporation.

(3) *Definitions.* For purposes of this section:

(i) *Significant holder* means any person that, immediately before the exchange—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is publicly traded; or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is not publicly traded.

(ii) *Publicly traded stock* means stock that is listed on—

(A) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(B) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(iii) *Issuing corporation* means the corporation that issued the shares of stock, some or all of which were transferred by a significant holder to such corporation in the exchange described in paragraph (d)(1) of this section.

(4) *Cross reference.* See section 6043 of the Code for requirements relating to a return by a liquidating corporation.

(e) *Example.* * * *

(f) *Effective/applicability date.* Paragraph (d) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (d) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before

May 30, 2006, see §1.331–1 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.331–1T [Removed]

Par. 7. Section 1.331–1T is removed.

Par. 8. Section 1.332–6 is added to read as follows:

§1.332–6 Records to be kept and information to be filed with return.

(a) *Statement filed by recipient corporation.* If any recipient corporation received a liquidating distribution from the liquidating corporation pursuant to a plan (whether or not that recipient corporation has received or will receive other such distributions from the liquidating corporation in other tax years as part of the same plan) during the current tax year, such recipient corporation must include a statement entitled, "STATEMENT PURSUANT TO SECTION 332 BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A CORPORATION RECEIVING A LIQUIDATING DISTRIBUTION," on or with its return for such year. If any recipient corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The name and employer identification number (if any) of the liquidating corporation;

(2) The date(s) of all distribution(s) (whether or not pursuant to the plan) by the liquidating corporation during the current tax year;

(3) The aggregate fair market value and basis, determined immediately before the liquidation, of all of the assets of the liquidating corporation that have been or will be transferred to any recipient corporation;

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with the liquidation;

(5) The following representation: THE PLAN OF COMPLETE LIQUIDATION WAS ADOPTED ON [INSERT DATE (mm/dd/yyyy)]; and

(6) A representation by such recipient corporation either that—

(i) THE LIQUIDATION WAS COMPLETED ON [INSERT DATE (mm/dd/yyyy)]; or

(ii) THE LIQUIDATION IS NOT COMPLETE AND THE TAXPAYER HAS TIMELY FILED [INSERT EITHER FORM 952, "*Consent To Extend the Time to Assess Tax Under Section 332(b)*," OR NUMBER AND NAME OF THE SUCCESSOR FORM].

(b) *Filings by the liquidating corporation.* The liquidating corporation must timely file Form 966, "*Corporate Dissolution or Liquidation*," (or its successor form) and its final Federal corporate income tax return. See also section 6043 of the Code.

(c) *Definitions.* For purposes of this section:

(1) *Plan* means the plan of complete liquidation within the meaning of section 332.

(2) *Recipient corporation* means the corporation described in section 332(b)(1).

(3) *Liquidating corporation* means the corporation that makes a distribution of property to a recipient corporation pursuant to the plan.

(4) *Liquidating distribution* means a distribution of property made by the liquidating corporation to a recipient corporation pursuant to the plan.

(d) *Substantiation information.* Under §1.6001–1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with a liquidation described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all distributed property, and relevant facts regarding any liabilities assumed or extinguished as part of such liquidation.

(e) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.332–6 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.332–6T [Removed]

Par. 9. Section 1.332–6T is removed.

Par. 10. Section 1.338–0 is amended by revising the entries for §§1.338–10(a)(4)(iii) and 1.338–10(c) and removing the entry for §1.338–10T to read as follows:

§1.338–0 Outline of topics.

* * * * *

§1.338–10 Filing of returns.

(a) * * *

(4) * * *

(iii) Procedure for filing a combined return.

* * * * *

(c) Effective/applicability date.

* * * * *

Par. 11. Section 1.338–10 is amended by revising paragraphs (a)(4)(iii) and (c) to read as follows:

§1.338–10 Filing of returns.

(a) * * *

(4) * * *

(iii) *Procedure for filing a combined return.* A combined return is made by filing a single corporation income tax return in lieu of separate deemed sale returns for all targets required to be included in the combined return. The combined return reflects the deemed asset sales of all targets required to be included in the combined return. If the targets included in the combined return constitute a single affiliated group within the meaning of section 1504(a), the income tax return is signed by an officer of the common parent of that group. Otherwise, the return must be signed by an officer of each target included in the combined return. Rules similar to the rules in §1.1502–75(j) apply for purposes of preparing the combined return. The combined return must include a statement entitled, "ELECTION TO FILE A COMBINED RETURN UNDER SECTION 338(h)(15)." The statement must include—

(A) The name, address, and employer identification number of each target required to be included in the combined return; and

(B) The following declaration: EACH TARGET IDENTIFIED IN THIS ELECTION TO FILE A COMBINED RETURN CONSENTS TO THE FILING OF A COMBINED RETURN.

* * * * *

(c) *Effective/applicability date.* Paragraph (a)(4)(iii) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (a)(4)(iii) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.338–10 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.338–10T [Removed]

Par. 12. Section 1.338–10T is removed.

Par. 13. Section 1.351–3 is added to read as follows:

§1.351–3 Records to be kept and information to be filed.

(a) *Significant transferor.* Every significant transferor must include a statement entitled, "STATEMENT PURSUANT TO §1.351–3(a) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT TRANSFEROR," on or with such transferor's income tax return for the taxable year of the section 351 exchange. If a significant transferor is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The name and employer identification number (if any) of the transferee corporation;

(2) The date(s) of the transfer(s) of assets;

(3) The aggregate fair market value and basis, determined immediately before the exchange, of the property transferred by such transferor in the exchange; and

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with the section 351 exchange.

(b) *Transferee corporation.* Except as provided in paragraph (c) of this section, every transferee corporation must include a statement entitled, "STATEMENT PURSUANT TO §1.351–3(b) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A TRANSFEREE CORPORATION," on or with its income tax return for the taxable year of the exchange. If the transferee corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The name and taxpayer identification number (if any) of every significant transferor;

(2) The date(s) of the transfer(s) of assets;

(3) The aggregate fair market value and basis, determined immediately before the exchange, of all of the property received in the exchange; and

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with the section 351 exchange.

(c) *Exception for certain transferee corporations.* The transferee corporation is not required to file a statement under paragraph (b) of this section if all of the information that would be included in the statement described in paragraph (b) of this section is included in any statement(s) described in paragraph (a) of this section that is attached to the same return for the same section 351 exchange.

(d) *Definitions.* For purposes of this section:

(1) *Significant transferor* means a person that transferred property to a corporation and received stock of the transferee corporation in an exchange described in section 351 if, immediately after the exchange, such person—

(i) Owned at least five percent (by vote or value) of the total outstanding stock of the transferee corporation if the stock owned by such person is publicly traded, or

(ii) Owned at least one percent (by vote or value) of the total outstanding stock of the transferee corporation if the stock owned by such person is not publicly traded.

(2) *Publicly traded stock* means stock that is listed on—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(e) *Substantiation information.* Under §1.6001–1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with the exchange described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all transferred property, and relevant facts regarding any liabilities assumed or extinguished as part of such exchange.

(f) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.351–3 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.351–3T [Removed]

Par. 14. Section 1.351–3T is removed.

Par. 15. Section 1.355–0 is amended by removing the entry for §1.355–5T and adding an entry for §1.355–5.

The revision and addition read as follows:

§1.355–0 Outline of sections.

* * * * *

§1.355–5 Records to be kept and information to be filed.

(a) Distributing corporation.

(1) In general.

(2) Special rule when an asset transfer precedes a stock distribution.

(b) Significant distributee.

(c) Definitions.
(1) Significant distributee.
(2) Publicly traded stock.
(d) Substantiation information.
(e) Effective/applicability date.

* * * * *

Par. 16. Section 1.355–5 is added to read as follows:

§1.355–5 Records to be kept and information to be filed.

(a) *Distributing corporation*—(1) *In general.* Every corporation that makes a distribution (the distributing corporation) of stock or securities of a controlled corporation, as described in section 355 (or so much of section 356 as relates to section 355), must include a statement entitled, "STATEMENT PURSUANT TO §1.355–5(a) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A DISTRIBUTING CORPORATION," on or with its return for the year of the distribution. If the distributing corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(i) The name and employer identification number (if any) of the controlled corporation;

(ii) The name and taxpayer identification number (if any) of every significant distributee;

(iii) The date of the distribution of the stock or securities of the controlled corporation;

(iv) The aggregate fair market value and basis, determined immediately before the distribution or exchange, of the stock, securities, or other property (including money) distributed by the distributing corporation in the transaction; and

(v) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with the transaction.

(2) *Special rule when an asset transfer precedes a stock distribution.* If the distributing corporation transferred property to the controlled corporation in a transaction described in section 351 or 368, as part of a plan to then distribute the stock or securities of the controlled corporation in a transaction described in section 355 (or so much of section 356 as relates to section 355), then, unless paragraph (a)(1)(v) of this section applies, the distributing corporation must also include on or with its return for the year of the distribution the statement required by §1.351–3(a) or 1.368–3(a). If the distributing corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include the statement required by §1.351–3(a) or 1.368–3(a) on or with its return.

(b) *Significant distributee.* Every significant distributee must include a statement entitled, "STATEMENT PURSUANT TO §1.355–5(b) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT DISTRIBUTEE," on or with such distributee's return for the year in which such distribution is received. If a significant distributee is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The names and employer identification numbers (if any) of the distributing and controlled corporations;

(2) The date of the distribution of the stock or securities of the controlled corporation; and

(3) The aggregate basis, determined immediately before the exchange, of any stock or securities transferred by the significant distributee in the exchange, and the aggregate fair market value, determined immediately before the distribution or exchange, of the stock, securities or other property (including money) received by the significant distributee in the distribution or exchange.

(c) *Definitions.* For purposes of this section:

(1) *Significant distributee* means—

(i) A holder of stock of a distributing corporation that receives, in a transaction described in section 355 (or so much of section 356 as relates to section 355), stock of a corporation controlled by the distributing corporation if, immediately before the distribution or exchange, such holder—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the distributing corporation if the stock owned by such holder is publicly traded; or

(B) Owned at least one percent (by vote or value) of the stock of the distributing corporation if the stock owned by such holder is not publicly traded; or

(ii) A holder of securities of a distributing corporation that receives, in a transaction described in section 355 (or so much of section 356 as relates to section 355), stock or securities of a corporation controlled by the distributing corporation if, immediately before the distribution or exchange, such holder owned securities in such distributing corporation with a basis of $1,000,000 or more.

(2) *Publicly traded stock* means stock that is listed on—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(d) *Substantiation information.* Under §1.6001–1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with the distribution or exchange described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all property distributed or exchanged, and relevant facts regarding any liabilities assumed or extinguished as part of such distribution or exchange.

(e) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.355–5 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.355–5T [Removed]

Par. 17. Section 1.355–5T is removed.

Par. 18. Section 1.368–3 is added to read as follows:

§1.368–3 Records to be kept and information to be filed with returns.

(a) *Parties to the reorganization.* The plan of reorganization must be adopted by each of the corporations that are parties thereto. Each such corporation must include a statement entitled, "STATEMENT PURSUANT TO §1.368–3(a) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A CORPORATION A PARTY TO A REORGANIZATION," on or with its return for the taxable year of the exchange. If any such corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. However, it is not necessary for any taxpayer to include more than one such statement on or with the same return for the same reorganization. The statement must include—

(1) The names and employer identification numbers (if any) of all such parties;

(2) The date of the reorganization;

(3) The aggregate fair market value and basis, determined immediately before the exchange, of the assets, stock or securities of the target corporation transferred in the transaction; and

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with this reorganization.

(b) *Significant holders.* Every significant holder, other than a corporation a party to the reorganization, must include a statement entitled, "STATEMENT PURSUANT TO §1.368–3(b) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT HOLDER," on or with such holder's return for the taxable year of the exchange. If a significant holder is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The names and employer identification numbers (if any) of all of the parties to the reorganization;

(2) The date of the reorganization; and

(3) The fair market value, determined immediately before the exchange, of all the stock or securities of the target corporation held by the significant holder that is transferred in the transaction and such holder's basis, determined immediately before the exchange, in the stock or securities of such target corporation.

(c) *Definitions.* For purposes of this section:

(1) *Significant holder* means—

(i) A holder of stock of the target corporation that receives stock or securities in an exchange described in section 354 (or so much of section 356 as relates to section 354) if, immediately before the exchange, such holder—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the target corporation if the stock owned by such holder is publicly traded; or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the target corporation if the stock owned by such holder is not publicly traded; or

(ii) A holder of securities of the target corporation that receives stock or securities in an exchange described in section 354 (or so much of section 356 as relates to section 354) if, immediately before the exchange, such holder owned securities in such target corporation with a basis of $1,000,000 or more.

(2) *Publicly traded stock* means stock that is listed on—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(d) *Substantiation information.* Under §1.6001–1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with the reorganization described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all transferred property, and relevant facts regarding any liabilities assumed or extinguished as part of such reorganization.

(e) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.368–3 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.368–3T [Removed]

Par. 19. Section 1.368–3T is removed.

Par. 20. Section 1.381(b)–1 is amended by revising paragraphs (b)(3) and (e) to read as follows:

§1.381(b)–1 Operating rules applicable to carryovers in certain corporate acquisitions.

* * * * *

(b) * * *

(3) *Election*—(i) *Content of statements.* The statements referred to in paragraph (b)(2) of this section must be entitled, "ELECTION OF DATE OF DISTRIBUTION OR TRANSFER PURSUANT TO §1.381(b)–1(b)(2)," and must include: [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF DISTRIBUTOR OR TRANSFEROR CORPORATION] AND [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF ACQUIRING CORPORATION] ELECT TO DETERMINE THE DATE OF DISTRIBUTION OR TRANSFER UNDER §1.381(b)–1(b)(2). SUCH DATE IS [INSERT DATE (mm/dd/yyyy)].

(ii) *Filing of statements.* One statement must be included on or with the timely filed Federal income tax return of the distributor or transferor corporation for its taxable year ending with the date of distribution or transfer. An identical statement must be included on or with the timely filed Federal income tax return of the acquiring corporation for its first taxable year ending after that date. If the distributor or transferor corporation, or the acquiring

corporation, is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return.

* * * * *

(e) *Effective/applicability date.* Paragraph (b)(3) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (b)(3) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.381(b)–1 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.381(b)–1T [Removed]

Par. 21. Section 1.381(b)–1T is removed.

Par. 22. Section 1.382–1 is amended by:

1. Revising the entry for §1.382–8(c)(2).
2. Revising the entry for §1.382–8(e)(4).
3. Revising the entry for §1.382–8(h).
4. Revising the entry for §1.382–8(j)(4).
5. Removing the entry for §1.382–8T.
6. Adding the entry for §1.382–11.
7. Removing the entry for §1.382–11T.

The additions and revisions read as follows:

§1.382–1 Table of contents.

* * * * *

§1.382–8 Controlled groups.

* * * * *

(c) * * *

(2) Restoration of value.

* * * * *

(e) * * *

(4) Foreign component member.

(i) In general.

(ii) Exception.

* * * * *

(h) Time and manner of filing election to restore.

(1) Statements required.

(i) Filing by loss corporation.

(ii) Filing by electing member.

(iii) Agreement.

(2) Special rule for foreign component members.

(i) Deemed election to restore full value.

(ii) Election not to restore full value.

(iii) Agreement.

(3) Revocation of election.

* * * * *

(j) * * *

(4) Effective/applicability date.

* * * * *

§1.382–11 Reporting requirements.

(a) Information statement required.

(b) Effective/applicability date.

Par. 23. Section 1.382–8 is amended by revising paragraphs (c)(2), (e)(4), (h) and (j)(4) to read as follows:

§1.382–8 Controlled groups.

* * * * *

(c) * * *

(2) *Restoration of value.* After the value of the stock of each component member is reduced pursuant to paragraph (c)(1) of this section, the value of the stock of each component member is increased by the amount of value, if any, restored to the component member by another component member (the electing member) pursuant to this paragraph (c)(2). The electing member may elect (or may be deemed to elect under paragraph (h)(2)(i) of this section in the case of a foreign component member) to restore value to another component member in an amount that does not exceed the lesser of—

(i) The sum of—

(A) The value, determined immediately before the ownership change, of the electing member's stock (after adjustment under paragraph (c)(1) of this section and before any restoration of value under this paragraph (c)(2)); plus

(B) Any amount of value restored to the electing member by another component member under this paragraph (c)(2); or

(ii) The value, determined immediately before any ownership change, of the electing member's stock (without regard to any adjustment under this section) that is directly owned by the other component member immediately after the ownership change.

* * * * *

(e) * * *

(4) *Foreign component member*—(i) *In general.* Except as provided in paragraph (e)(4)(ii) of this section, foreign component member means a component member that is a foreign corporation.

(ii) *Exception.* A foreign component member shall not include a foreign corporation that has items treated as connected with the conduct of a trade or business in the United States that it takes into account in determining its value pursuant to section 382(e)(3).

* * * * *

(h) *Time and manner of filing election to restore*—(1) *Statements required*— (i) *Filing by loss corporation.* The election to restore value described in paragraph (c)(2) of this section must be in the form set forth in this paragraph (h)(1)(i). It must be filed by the loss corporation by including a statement on or with its income tax return for the taxable year in which the ownership change occurs (or with an amended return for that year filed on or before the due date (including extensions) of the income tax return of any component member with respect to the taxable year in which the ownership change occurs). The common parent of a consolidated group must make the election on behalf of the group. The election is made in the form of a statement entitled, "STATEMENT PURSUANT TO §1.382–8(h)(1) TO ELECT TO RESTORE ALL OR PART OF THE VALUE OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF THE ELECTING MEMBER] TO [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF THE CORPORATION TO WHICH VALUE IS RESTORED]." The statement must include the amount of the value being restored and must also indicate that an agreement signed and dated by both parties, as described in paragraph (h)(1)(iii) of this section, has been entered into. Each such party must retain either the original or a copy of this agreement as part of its records. See §1.6001–1(e).

(ii) *Filing by electing member.* An electing member must include a statement identical to the one described in paragraph (h)(1)(i) of this section on or with its

income tax return (or with an amended return for that year filed on or before the due date (including extensions) of the income tax return of any component member with respect to the taxable year in which the ownership change occurs) (if any) for the taxable year which includes the change date in connection with which the election described in paragraph (c)(2) of this section is made. If the electing member is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. It is not necessary for the electing member (or the United States shareholder, as the case may be) to include this statement on or with its return if the loss corporation includes an identical statement on or with the same return for the same election.

(iii) *Agreement.* Both the electing member and the corporation to which value is restored must sign and date an agreement. The agreement must—

(A) Identify the change date for the loss corporation in connection with which the election is made;

(B) State the value of the electing member's stock (without regard to any adjustment under paragraph (c) of this section) immediately before the ownership change;

(C) State the amount of any reduction required under paragraph (c)(1) of this section with respect to stock of the electing member that is owned directly or indirectly by the corporation to which value is restored;

(D) State the amount of value that the electing member elects to restore to the corporation; and

(E) State whether the value of either component member's stock was adjusted pursuant to paragraph (c)(4) of this section.

(2) *Special rule for foreign component members*—(i) *Deemed election to restore full value.* Unless the election described in paragraph (h)(2)(ii) of this section is made for a foreign component member, each foreign component member of the controlled group is deemed to have elected to restore to each other component member the maximum value allowable under paragraph (c)(2) of this section, taking into account the limitations of this section.

(ii) *Election not to restore full value.* (A) A loss corporation may elect to reduce the amount of value restored from a foreign component member (the electing foreign component member) to another component member under paragraph (h)(2)(i) of this section in the form set forth in this paragraph (h)(2)(ii). It must be filed by the loss corporation by including a statement on or with its income tax return for the taxable year in which the ownership change occurs (or with an amended return for that year filed on or before the due date (including extensions) of the income tax return of any component member with respect to the taxable year in which the ownership change occurs). The common parent of a consolidated group must make the election on behalf of the group. The election is made in the form of a statement entitled, "STATEMENT PURSUANT TO §1.382–8(h)(2)(ii) TO ELECT NOT TO RESTORE FULL VALUE OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF ELECTING FOREIGN COMPONENT MEMBER] TO [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF THE CORPORATION TO WHICH SUCH VALUE IS NOT TO BE RESTORED]." The statement must include the amount of the value not being restored and must also indicate that an agreement signed and dated by both parties, as described in paragraph (h)(2)(iii) of this section, has been entered into. Each such party must retain either the original or a copy of the agreement as part of its records. See §1.6001–1(e).

(B) An electing foreign component member must include a statement identical to the one described in paragraph (h)(2)(ii)(A) of this section on or with its income tax return (or with an amended return for that year filed on or before the due date (including extensions) of the income tax return of any component member with respect to the taxable year in which the ownership change occurs) (if any) for the taxable year which includes the change date in connection with which the election described in paragraph (h)(2)(ii)(A) of this section is made. If the electing foreign component member is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. It is not necessary for the electing foreign component member (or United States shareholder, as the case may be) to include this statement on or with its return if the loss corporation includes an identical statement on or with the same return for the same election.

(iii) *Agreement.* Both the electing foreign component member and the corporation to which full value is not restored must sign and date an agreement. The agreement must—

(A) Identify the change date for the loss corporation in connection with which the election is made;

(B) State the value of the electing foreign component member's stock (without regard to any adjustment under paragraph (c) of this section) immediately before the ownership change;

(C) State the amount of any reduction required under paragraph (c)(1) of this section with respect to stock of the electing foreign component member that is owned directly or indirectly by the corporation to which value is not restored;

(D) State the amount of value that the electing foreign component member elects not to restore to the corporation; and

(E) State whether the value of either component member's stock was adjusted pursuant to paragraph (c)(4) of this section.

(3) *Revocation of election.* An election (other than the deemed election described in paragraph (h)(2)(i) of this section) made under this section is revocable only with the consent of the Commissioner.

* * * * *

(j) * * *

(4) *Effective/applicability date.* Paragraphs (c)(2), (e)(4) and (h) of this section apply to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraphs (c)(2), (e)(4) and (h) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.382–8 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.382–8T [Removed]

Par. 24. Section 1.382–8T is removed.

Par. 25. Section 1.382–11 is added to read as follows:

§1.382–11 Reporting requirements.

(a) *Information statement required.* A loss corporation must include a statement entitled, "STATEMENT PURSUANT TO §1.382–11(a) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF TAXPAYER], A LOSS CORPORATION," on or with its income tax return for each taxable year that it is a loss corporation in which an owner shift, equity structure shift or other transaction described in §1.382–2T(a)(2)(i) occurs. The statement must include the date(s) of any owner shifts, equity structure shifts, or other transactions described in §1.382–2T(a)(2)(i), the date(s) on which any ownership change(s) occurred, and the amount of any attributes described in §1.382–2(a)(1)(i) that caused the corporation to be a loss corporation. A loss corporation may also be required to include certain elections on this statement, including—

(1) An election made under §1.382–2T(h)(4)(vi)(B) to disregard the deemed exercise of an option if the actual exercise of that option occurred within 120 days of the ownership change; and

(2) An election made under §1.382–6(b)(2) to close the books of the loss corporation for purposes of allocating income and loss to periods before and after the change date for purposes of section 382.

(b) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.382–2T as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.382–11T [Removed]

Par. 26. Section 1.382–11T is removed.

Par. 27. Section 1.1081–11 is added to read as follows:

§1.1081–11 Records to be kept and information to be filed with returns.

(a) *Distributions and exchanges; significant holders of stock or securities.* Every significant holder must include a statement entitled, "STATEMENT PURSUANT TO §1.1081–11(a) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SIGNIFICANT HOLDER," on or with such holder's income tax return for the taxable year in which the distribution or exchange occurs. If a significant holder is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The name and employer identification number (if any) of the corporation from which the stock, securities, or other property (including money) was received by such significant holder;

(2) The aggregate basis, determined immediately before the exchange, of any stock or securities transferred by the significant holder in the exchange, and the aggregate fair market value, determined immediately before the distribution or exchange, of the stock, securities or other property (including money) received by the significant holder in the distribution or exchange; and

(3) The date of the distribution or exchange.

(b) *Distributions and exchanges; corporations subject to Commission orders.* Each corporation which is a party to a distribution or exchange made pursuant to an order of the Commission must include on or with its income tax return for its taxable year in which the distribution or exchange takes place a statement entitled, "STATEMENT PURSUANT TO §1.1081–11(b) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A DISTRIBUTING OR EXCHANGING CORPORATION." If the distributing or exchanging corporation is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The date and control number of the Commission order, pursuant to which the distribution or exchange was made;

(2) The names and taxpayer identification numbers (if any) of the significant holders;

(3) The aggregate fair market value and basis, determined immediately before the distribution or exchange, of the stock, securities, or other property (including money) transferred in the distribution or exchange; and

(4) The date of the distribution or exchange.

(c) *Sales by members of system groups.* Each system group member must include a statement entitled, "STATEMENT PURSUANT TO §1.1081–11(c) BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER], A SYSTEM GROUP MEMBER," on or with its income tax return for the taxable year in which the sale is made. If any system group member is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The statement must include—

(1) The dates and control numbers of all relevant Commission orders;

(2) The aggregate fair market value and basis, determined immediately before the sale, of all stock or securities sold; and

(3) The date of the sale.

(d) *Definitions.* (1) For purposes of this section, *Commission* means the Securities and Exchange Commission.

(2) For purposes of this section, *significant holder* means a person that receives stock or securities from a corporation (the distributing corporation) pursuant to an order of the Commission, if, immediately before the transaction, such person—

(i) In the case of stock—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the distributing corporation if the stock owned by such person is publicly traded, or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the distributing corporation if the stock owned by such person is not publicly traded; or

(ii) In the case of securities, owned securities of the distributing corporation with a basis of $1,000,000 or more.

(3) *Publicly traded stock* means stock that is listed on—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o–3).

(4) For purposes of paragraph (b) of this section, *exchange* means exchange, expenditure, or investment.

(5) For purposes of paragraph (c) of this section, *system group member* means each corporation which is a member of a system group and which, pursuant to an order of the Commission, sells stock or securities received upon an exchange (pursuant to an order of the Commission) and applies the proceeds derived therefrom in retirement or cancellation of its own stock or securities.

(e) *Substantiation information.* Under §1.6001–1(e), taxpayers are required to retain their permanent records and make such records available to any authorized Internal Revenue Service officers and employees. In connection with the distribution or exchange described in this section, these records should specifically include information regarding the amount, basis, and fair market value of all property distributed or exchanged, and relevant facts regarding any liabilities assumed or extinguished as part of such distribution or exchange.

(f) *Effective/applicability date.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.1081–11 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1081–11T [Removed]

Par. 28. Section 1.1081–11T is removed.

Par. 29. Section 1.1221–2 is amended by revising paragraphs (e)(2)(iv) and (j) to read as follows:

§1.1221–2 Hedging transactions.

* * * * *

(e) * * *

(2) * * *

(iv) *Making and revoking the election.* Unless the Commissioner otherwise prescribes, the election described in paragraph (e)(2) of this section must be made in a separate statement that provides, "[INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF COMMON PARENT] HEREBY ELECTS THE APPLICATION OF §1.1221–2(e)(2) (THE SEPARATE-ENTITY APPROACH)." The statement must also indicate the date as of which the election is to be effective. The election must be filed by including the statement on or with the consolidated group's income tax return for the taxable year that includes the first date for which the election is to apply. The election applies to all transactions entered into on or after the date so indicated. The election may only be revoked with the consent of the Commissioner.

* * * * *

(j) *Effective/applicability date.* Paragraph (e)(2)(iv) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1221–2T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1221–2 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1221–2T [Removed]

Par. 30. Section 1.1221–2T is removed.

Par. 31. Section 1.1502–13 is amended by revising paragraphs (f)(5)(ii)(E), (f)(6)(i)(C)(*2*) and (m) to read as follows:

§1.1502–13 Intercompany transactions.

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(E) *Election.* An election to apply paragraph (f)(5)(ii) of this section is made in a separate statement entitled, "[INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF COMMON PARENT] HEREBY ELECTS THE APPLICATION OF §1.1502–13(f)(5)(ii) FOR AN INTERCOMPANY TRANSACTION INVOLVING [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF S] AND [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF T]." A separate election must be made for each such application. The election must be filed by including the statement on or with the consolidated group's income tax return for the year of T's liquidation (or other transaction). The Commissioner may impose reasonable terms and conditions to the application of paragraph (f)(5)(ii) of this section that are consistent with the purposes of such section. The statement must—

(*1*) Identify S's intercompany transaction and T's liquidation (or other transaction); and

(*2*) Specify which provision of paragraph (f)(5)(ii) of this section applies and how it alters the otherwise applicable results under this section (including, for example, the amount of S's intercompany items and the amount deferred or offset as a result of paragraph (f)(5)(ii) of this section).

(6) * * *

(i) * * *

(C) * * *

(*2*) *Election.* The election described in paragraph (f)(6)(i)(C)(*1*) of this section must be made in a separate statement entitled, "ELECTION TO REDUCE BASIS OF P STOCK UNDER §1.1502–13(f)(6) HELD BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF MEMBER WHOSE BASIS IN P STOCK IS REDUCED]." The election must be filed by including the statement on or with the consolidated group's income tax return for the year in which the nonmember becomes a member. The statement must identify the member's basis in the P stock (taking into account the effect of this election) and the number of shares of P stock held by the member.

* * * * *

(m) *Effective/applicability date.* Paragraphs (f)(5)(ii)(E) and (f)(6)(i)(C)(2) of this section apply to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–13T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–13 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–13T [Removed]

Par. 32. Section 1.1502–13T is removed.

Par. 33. Section 1.1502–31 is amended by revising paragraphs (e)(2) and (j) to read as follows:

§1.1502–31 Stock basis after a group structure change.

* * * * *

(e) * * *

(2) *Election.* The election described in paragraph (e)(1) of this section must be made in a separate statement entitled, "ELECTION TO TREAT LOSS CARRYOVER AS EXPIRING UNDER §1.1502–31(e)." The election must be filed by including the statement on or with the consolidated group's income tax return for the year that includes the group structure change. The statement must identify the amount of each loss carryover deemed to expire (or the amount of each loss carryover deemed not to expire, with any balance of any loss carryovers being deemed to expire).

* * * * *

(j) *Effective/applicability date.* Paragraph (e)(2) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–31T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–31 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–31T [Removed]

Par. 34. Section 1.1502–31T is removed.

Par. 35. Section 1.1502–32 is amended by revising paragraphs (b)(4)(iv) and (j) to read as follows:

§1.1502–32 Investment adjustments.

* * * * *

(b) * * *

(4) * * *

(iv) *Election.* The election described in paragraph (b)(4) of this section must be made in a separate statement entitled, "ELECTION TO TREAT LOSS CARRYOVER OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF S] AS EXPIRING UNDER §1.1502–32(b)(4)." The election must be filed by including a statement on or with the consolidated group's income tax return for the year S becomes a member. A separate statement must be made for each member whose loss carryover is deemed to expire. The statement must identify the amount of each loss carryover deemed to expire (or the amount of each loss carryover deemed not to expire, with any balance of any loss carryovers being deemed to expire) and the basis of any stock reduced as a result of the deemed expiration.

* * * * *

(j) *Effective/applicability date.* Paragraph (b)(4)(iv) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–32T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–32 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–32T [Amended]

Par. 36. Section 1.1502–32T is amended by removing and reserving paragraphs (b)(4)(iv) and (j).

Par. 37. Section 1.1502–33 is amended by revising paragraphs (d)(5)(i)(D) and (k) to read as follows:

§1.1502–33 Earnings and profits.

* * * * *

(d) * * *

(5) * * *

(i) * * *

(D) If a method is permitted under paragraph (d)(4) of this section, provide the date and control number of the private letter ruling issued by the Internal Revenue Service approving such method.

* * * * *

(k) *Effective/applicability date.* Paragraph (d)(5)(i)(D) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–33T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–33 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–33T [Removed]

Par. 38. Section 1.1502–33T is removed.

Par. 39. Section 1.1502–90 is amended by:

1. Revising the entry for §1.1502–95(e)(8).
2. Revising the entry for §1.1502–95(f).
3. Revising the entry for §1.1502–95(g).
4. Removing the entry for §1.1502–95T.

The revisions read as follows:

§1.1502–90 Table of contents.

* * * * *

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

* * * * *

(e) * * *

(8) Reporting requirements.

(i) Common Parent.

(ii) Former Member.

(iii) Exception.

(f) Filing the election to apportion the section 382 limitation and net unrealized built-in gain.

(1) Form of the election to apportion.

(i) Statement.

(ii) Agreement.

(2) Signing the agreement.

(3) Filing the election.

(i) Filing by the common parent.

(ii) Filing by the former member.

(4) Revocation of election.

(g) Effective/applicability date.

* * * * *

Par. 40. Section 1.1502–95 is amended by revising paragraphs (e)(8), (f) and (g) to read as follows:

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

* * * * *

(e) * * *

(8) *Reporting requirements*—(i) *Common Parent.* Except as provided in paragraph (e)(8)(iii) of this section, if a net unrealized built-in loss is allocated under paragraph (e) of this section, the common parent must include a statement entitled, "STATEMENT OF NET UNREALIZED BUILT-IN LOSS ALLOCATION PURSUANT TO §1.1502–95(e)," on or with its income tax return for the taxable year in which the former member(s) (or a new loss subgroup that includes that member) ceases to be a member. The statement must include—

(A) The name and employer identification number of the departing member;

(B) The amount of the remaining NUBIL balance for the taxable year in which the member departs;

(C) The amount of the net unrealized built-in loss allocated to the departing member; and

(D) A representation that the common parent has delivered a copy of the statement to the former member (or the common parent of the group of which the former member is a member) on or before the day the group files its income tax return for the consolidated return year that the former member ceases to be a member.

(ii) *Former Member.* Except as provided in paragraph (e)(8)(iii) of this section, the former member must include a statement on or with its first income tax return (or the first return in which the former member joins) that is filed after the close of the consolidated return year of the group of which the former member (or a new loss subgroup that includes that member) ceases to be a member. The statement will be identical to the statement filed by the common parent under paragraph (e)(8)(i) of this section except that instead of including the information described in paragraph (e)(8)(i)(A) of this section the former member must provide the name, employer identification number and tax year of the former common parent, and instead of the representation described in paragraph (e)(8)(i)(D) of this section the former member must represent that it has received and retained the copy of the statement delivered by the common parent as part of its records. See §1.6001–1(e).

(iii) *Exception.* This paragraph (e)(8) does not apply if the required information (other than the amount of the remaining NUBIL balance) is included in a statement of election under paragraph (f) of this section (relating to apportioning a section 382 limitation).

(f) *Filing the election to apportion the section 382 limitation and net unrealized built-in gain*—(1) *Form of the election to apportion*—(i) *Statement.* An election under paragraph (c) of this section must be made in the form set forth in this paragraph (f)(1)(i). The election must be made by the common parent and the party described in paragraph (f)(2) of this section. It must be filed in accordance with paragraph (f)(3) of this section and be entitled, "THIS IS AN ELECTION UNDER §1.1502–95 TO APPORTION ALL OR PART OF THE [INSERT THE CONSOLIDATED SECTION 382 LIMITATION, THE SUBGROUP SECTION 382 LIMITATION, THE LOSS GROUP'S NET UNREALIZED BUILT-IN GAIN, OR THE LOSS SUBGROUP'S NET UNREALIZED BUILT-IN GAIN, AS APPROPRIATE] IN THE AMOUNT OF [INSERT THE AMOUNT OF THE LOSS LIMITATION OR NET UNREALIZED BUILT-IN GAIN] TO [INSERT NAME(S) AND EMPLOYER IDENTIFICATION NUMBER(S) OF THE CORPORATION (OR THE CORPORATIONS THAT COMPOSE A NEW LOSS SUBGROUP) TO WHICH ALLOCATION IS MADE]." The statement must also indicate that an agreement, as described in paragraph (f)(1)(ii) of this section, has been entered into.

(ii) *Agreement.* Both the common parent and the party described in paragraph (f)(2) of this section must sign and date the agreement. The agreement must include, as appropriate—

(A) The date of the ownership change that resulted in the consolidated section 382 limitation (or subgroup section 382 limitation) or the loss group's (or loss subgroup's) net unrealized built-in gain;

(B) The amount of the departing member's (or loss subgroup's) pre-change net operating loss carryovers and the taxable years in which they arose that will be subject to the limitation that is being apportioned to that member (or loss subgroup);

(C) The amount of any net unrealized built-in loss allocated to the departing member (or loss subgroup) under paragraph (e) of this section, which, if recognized, can be a pre-change attribute subject to the limitation that is being apportioned;

(D) If a consolidated section 382 limitation (or subgroup section 382 limitation) is being apportioned, the amount of the consolidated section 382 limitation (or subgroup section 382 limitation) for the taxable year during which the former member (or new loss subgroup) ceases to be a member of the consolidated group (determined without regard to any apportionment under this section);

(E) If any net unrealized built-in gain is being apportioned, the amount of the loss group's (or loss subgroup's) net unrealized built-in gain (as determined under paragraph (c)(2)(ii) of this section) that may be apportioned to members that ceased to be members during the consolidated return year;

(F) The amount of the value element and adjustment element of the consolidated section 382 limitation (or subgroup section 382 limitation) that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(G) The amount of the loss group's (or loss subgroup's) net unrealized built-in gain that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(H) If the former member is allocated any net unrealized built-in loss under para-

graph (e) of this section, the amount of any adjustment element apportioned to the former member that is attributable to recognized built-in gains (determined in a manner that will enable both the group and the former member to apply the principles of §1.1502–93(c)); and

(I) The name and employer identification number of the common parent making the apportionment.

(2) *Signing the agreement.* The agreement must be signed by both the common parent and the former member (or, in the case of a loss subgroup, the common parent and the loss subgroup parent) by persons authorized to sign their respective income tax returns. If the allocation is made to a loss subgroup for which an election under §1.1502–91(d)(4) is made, and not separately to its members, the agreement under this paragraph (f) must be signed by the common parent and any member of the new loss subgroup by persons authorized to sign their respective income tax returns. Each party signing the agreement must retain either the original or a copy of the agreement as part of its records. See §1.6001–1(e).

(3) *Filing of the election*—(i) *Filing by the common parent.* The election must be filed by the common parent of the group that is apportioning the consolidated section 382 limitation (or the subgroup section 382 limitation) or the loss group's net unrealized built-in gain (or loss subgroup's net unrealized built-in gain) by including the statement on or with its income tax return for the taxable year in which the former member (or new loss subgroup) ceases to be a member.

(ii) *Filing by the former member.* An identical statement must be included on or with the first return of the former member (or the first return in which the former member, or the members of a new loss subgroup, join) that is filed after the close of the consolidated return year of the group of which the former member (or the members of a new loss subgroup) ceases to be a member.

(4) *Revocation of election.* An election statement made under paragraph (c) of this section is revocable only with the consent of the Commissioner.

(g) *Effective/applicability date.* Paragraphs (e)(8) and (f) of this section apply to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–95T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–95 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–95T [Removed]

Par. 41. Section 1.1502–95T is removed.

Par. 42. Section 1.1563–3 is amended by revising paragraph (d)(2)(iv), adding paragraph (d)(2)(v) and revising (e) to read as follows:

§1.1563–3 Rules for determining stock ownership.

* * * * *

(d) * * *

(2) * * *

(iv) *Statement.* If the application of paragraph (d)(2)(ii) or (iii) of this section does not result in a corporation being treated as a component member of only one controlled group of corporations on a December 31, then such corporation will be treated as a component member of only one such group on such date. Such corporation may elect the group in which it is to be included by including on or with its income tax return a statement entitled, "STATEMENT TO ELECT CONTROLLED GROUP PURSUANT TO §1.1563–3(d)(2)(iv)." The statement must include—

(A) A description of each of the controlled groups in which the corporation could be included. The description must include the name and employer identification number of each component member of each such group and the stock ownership of the component members of each such group; and

(B) The following representation: [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF CORPORATION] ELECTS TO BE TREATED AS A COMPONENT MEMBER OF THE [INSERT DESIGNATION OF GROUP].

(v) *Election*—(A) *Election filed.* An election filed under paragraph (d)(2)(iv) of this section is irrevocable and effective until paragraph (d)(2)(ii) or (iii) of this section applies or until a change in the stock ownership of the corporation results in termination of membership in the controlled group in which such corporation has been included.

(B) *Election not filed.* In the event no election is filed in accordance with the provisions of paragraph (d)(2)(iv) of this section, then the Internal Revenue Service will determine the group in which such corporation is to be included. Such determination will be binding for all subsequent years unless the corporation files a valid election with respect to any such subsequent year or until a change in the stock ownership of the corporation results in termination of membership in the controlled group in which such corporation has been included.

* * * * *

(e) *Effective/applicability date.* Paragraph (d)(2)(iv) and (v) of this section apply to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (d)(2)(iv) and (v) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.1563–3 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1563–3T [Removed]

Par. 43. Section 1.1563–3T is removed.

Par. 44. Section 1.6012–2 is amended by revising paragraphs (c) and (k) to read as follows:

§1.6012–2 Corporations required to make returns of income.

* * * * *

(c) *Insurance companies*—(1) *Domestic life insurance companies*—(i) *In general.* A life insurance company subject to tax under section 801 shall make a return on Form 1120–L, "*U.S. Life Insurance Company Income Tax Return.*" Except as provided in paragraph (c)(4) of this section, such company shall file with its return—

(A) A copy of its annual statement which shows the reserves used by the company in computing the taxable income reported on its return; and

(B) A copy of Schedule A (real estate) and of Schedule D (bonds and stocks), or any successor thereto, of such annual statement.

(ii) *Mutual savings banks.* Mutual savings banks conducting life insurance business and meeting the requirements of section 594 are subject to partial tax computed on Form 1120, "*U.S. Corporation Income Tax Return*," and partial tax computed on Form 1120–L. The Form 1120–L is attached as a schedule to Form 1120, together with the annual statement and schedules required to be filed with Form 1120–L.

(2) *Domestic nonlife insurance companies.* Every domestic insurance company other than a life insurance company shall make a return on Form 1120–PC, "*U.S. Property and Casualty Insurance Company Income Tax Return.*" This includes organizations described in section 501(m)(1) that provide commercial-type insurance and organizations described in section 833. Except as provided in paragraph (c)(4) of this section, such company shall file with its return a copy of its annual statement (or a *pro forma* annual statement), including the underwriting and investment exhibit (or any successor thereto) for the year covered by such return.

(3) *Foreign insurance companies.* The provisions of paragraphs (c)(1) and (c)(2) of this section concerning the returns and statements of insurance companies subject to tax under section 801 or section 831 also apply to foreign insurance companies subject to tax under those sections, except that the copy of the annual statement required to be submitted with the return shall, in the case of a foreign insurance company that is not required to file an annual statement, be a copy of the *pro forma* annual statement relating to the United States business of such company.

(4) *Exception for insurance companies filing their Federal income tax returns electronically.* If an insurance company described in paragraph (c)(1), (c)(2), or (c)(3) of this section files its Federal income tax return electronically, it should not include on or with such return its annual statement (or *pro forma* annual statement), or any portion thereof. Such statement must be available at all times for inspection by authorized Internal Revenue Service officers or employees and retained for so long as such statements may be material in the administration of any internal revenue law. See §1.6001–1(e).

(5) *Definition.* For purposes of this section, the term *annual statement* means the annual statement, the form of which is approved by the National Association of Insurance Commissioners (NAIC), which is filed by an insurance company for the year with the insurance departments of States, Territories, and the District of Columbia. The term annual statement also includes a *pro forma* annual statement if the insurance company is not required to file the NAIC annual statement.

* * * * *

(k) *Effective/applicability date.* Paragraph (c) of this section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraph (c) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see §1.6012–2 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.6012–2T [Removed]

Par. 45. Section 1.6012–2T is removed.

§§1.302–4, 1.338(h)(10)–1, 1.382–2T, 1.382–6, 1.382–8, 1.1502–13, 1.1502–32, 1.1502–92, 1.1502–94, 1.1502–95, 1.1563–3, and 1.6043–2 [Amended]

Par. 46. For each entry in the "Location" column of the following table, remove the language in the "Remove" column and add the language in the "Add" column in its place:

Location	Remove	Add
The last sentence of the introductory text to §1.302–4	The rules described in paragraph (a) of §1.302–4T and in paragraphs (b) through (g) of this section apply in determining whether the specific requirements of section 302(c)(2) are met.	The following rules shall be applicable in determining whether the specific requirements of section 302(c)(2) are met:
§1.338(h)(10)–1(f)	§1.331–1T(d) and §1.332–6T	§1.331–1(d), and §1.332–6
§1.382–2T(a)(2)(ii)	§1.382–11T	§1.382–11
The last sentence of §1.382–2T(h)(4)(vi)(B)	paragraph (a) of §1.382–11T	§1.382–11(a)
The first sentence of §1.382–6(b)(2)(i)	§1.382–11T(a)	§1.382–11(a)
The second sentence of §1.382–8(a)	paragraphs (c)(1), (c)(3), (c)(4) and (c)(5) of this section and paragraph (c)(2) of §1.382–8T	paragraph (c) of this section
The third sentence of §1.382–8(a)	paragraphs (c)(1), (c)(3), (c)(4) and (c)(5) of this section and paragraph (c)(2) of §1.382–8T	paragraph (c) of this section
§1.382–8(c)(3)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section

Location	Remove	Add
The first sentence of §1.382–8(c)(4)	paragraphs (c)(1) and (c)(3) of this section and paragraph (c)(2) of §1.382–8T	paragraphs (c)(1), (2), and (3) of this section
§1.382–8(c)(5)	paragraphs (c)(1), (c)(3), (c)(4), and (c)(5) of this section, and paragraph (c)(2) of §1.382–8T	this paragraph (c)
The fifth sentence of §1.382–8(f)	paragraphs (c)(1), (c)(3), (c)(4), and (c)(5) of this section, and paragraph (c)(2) of §1.382–8T	paragraph (c) of this section
§1.382–8(g), *Example* (1)(b)(2)	paragraphs (c)(1), (c)(3), (c)(4), and (c)(5) of this section, and paragraph (c)(2) of §1.382–8T	paragraph (c) of this section
The second sentence of §1.382–8(g), *Example* (1)(c)	paragraphs (c)(1), (c)(3), (c)(4), and (c)(5) of this section, and paragraph (c)(2) of §1.382–8T	paragraph (c) of this section
§1.382–8(g), *Example* (2)(c)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section
The first sentence of §1.382–8(g), *Example* (2)(e)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section
§1.382–8(g), *Example* (3)(b)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section
§1.382–8(g), *Example* (3)(c)(1)(B)	paragraph (c)(1) of this section and paragraph (c)(2) of §1.382–8T	paragraphs (c)(1) and (2) of this section
The second sentence of §1.382–8(g), *Example* (4)(c)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section
The second sentence of §1.382–8(g), *Example* (5)(c)	paragraph (c)(2) of §1.382–8T	paragraph (c)(2) of this section
§1.1502–13(a)(6)(ii), *Matching rule*, Example 13.	Manufacturer incentive payments.	[Reserved]
The first sentence of §1.1502–32(b)(4)(v)(A)	paragraph (b)(4)(iv) of §1.1502–32T	paragraph (b)(4)(iv) of this section
The first sentence of §1.1502–32(b)(4)(v)(B)	paragraph (b)(4)(iv) of §1.1502–32T	paragraph (b)(4)(iv) of this section
§1.1502–92(e)(1)	§1.382–11T(a)	§1.382–11(a)
The first sentence of §1.1502–92(e)(2)	§1.382–11T(a)	§1.382–11(a)
The first sentence of §1.1502–94(d)	§1.382–11T(a)	§1.382–11(a)
The second sentence of §1.1502–94(d)	§1.382–11T(a)	§1.382–11(a)
The last sentence of §1.1502–95(b)(3)	paragraph (f) of §1.1502–95T	paragraph (f) of this section
The second sentence of §1.1563–3(d)(2)(i)	paragraphs (d)(2)(ii) and (iii) of this section, and paragraph (d)(2)(iv) of §1.1563–3T	paragraphs (d)(2)(ii), (iii) and (iv) of this section
The first sentence of §1.6043–2(a)	§1.332–6T(a), §1.368–3T(a), or §1.1081–11T	§1.332–6(b), 1.368–3(a), or 1.1081–11

PART 301—PROCEDURE AND ADMINISTRATION

Par. 46a. The authority citation for part 300 continues to read in part as follows:

Authority: 26 U.S.C. 7805* * *

Section 301.6011–5T also issued under 26 U.S.C. 6011.

§301.6011–5T [Amended]

Par. 46b. In the following table, remove the language in the "remove" column and add the text from the "add" column in its place.

Location	Remove	Add
The first sentence of §301.6011–5T(a) (**twice**)	paragraphs (a), (b) and (d) through (j) of §1.6012–2, and paragraph (c) of §1.6012–2T	§1.6012–2

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 47. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 48.

1. In §602.101(b), the following entries to the table are removed:

1.302–2T	1545–2019
1.302–4T	1545–2019
1.331–1T	1545–2019
1.332–6T	1545–2019
1.338–10T	1545–2019
1.351–3T	1545–2019
1.355–5T	1545–2019
1.368–3T	1545–2019
1.381(b)–1T	1545–2019
1.382–8T	1545–2019
1.382–11T	1545–2019
1.1081–11T	1545–2019
1.1221–2T	1545–2019
1.1502–13T	1545–2019
1.1502–31T	1545–2019
1.1502–32T	1545–2019
1.1502–33T	1545–2019
1.1502–95T	1545–2019
1.1563–3T	1545–2019
1.6012–2T	1545–2019

2. In §602.101(b), the following entries to the table are added:

1.332–6	1545–2019
1.351–3	1545–2019
1.355–5	1545–2019
1.368–3	1545–2019
1.382–11	1545–2019
1.1081–11	1545–2019

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 4, 2007.

Eric Solomon,
Assistant Secretary of the Treasury.

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Section 1563.—Definitions and Special Rules

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on or with their Federal income tax returns. See T.D. 9329, page 312.

Section 6012.—Persons Required to Make Returns of Income

Final regulations simplify, clarify, or eliminate taxpayer reporting burdens. They also eliminate regulatory impediments to the electronic filing of certain statements that taxpayers are required to include on

or with their Federal income tax returns. See T.D. 9329, page 312.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2007. See Rev. Rul. 2007-50, page 311.

Part III. Administrative, Procedural, and Miscellaneous

Excluded Bona Fide Severance Pay Plans Under § 457(e)(11) and Amounts Subject to a Substantial Risk of Forfeiture Under § 457(f)

Notice 2007–62

I. PURPOSE

This notice announces the intent of the Treasury Department (Treasury) and the Internal Revenue Service (Service) to issue guidance under § 457, which applies to nonqualified deferred compensation plans of state and local governments and tax-exempt entities, concerning the definitions of a *bona fide* severance pay plan under § 457(e)(11) and concerning the definition of substantial risk of forfeiture under § 457(f)(1)(B). This notice also describes the guidance that the Treasury and the Service anticipate issuing, which in many respects would be similar to the rules in the recent final regulations under § 409A, and requests comments on the issues intended to be addressed by such guidance.

II. BACKGROUND

Section 457 applies to nonqualified deferred compensation plans established by state and local government and tax-exempt employers. Three types of nonqualified deferred compensation plans are subject to § 457: (1) an eligible § 457(b) plan established by a state or local government employer; (2) an eligible § 457(b) plan established by any other tax-exempt entity that is not a governmental entity; and (3) any other deferred compensation plan established by either type of employer (an ineligible nonqualified deferred compensation plan). An ineligible nonqualified deferred compensation plan is subject to § 457(f). Section 457(f)(3)(A) provides that the term plan includes any agreement or arrangement.

Section 457(e)(11) states that § 457 does not apply to certain types of plans, including a *bona fide* severance pay plan. Section 457(f)(2) provides that the rules of § 457(f) do not apply to a qualified plan under § 401(a) or § 403(a), a § 403(b) annuity, a nonqualified annuity described in § 403(c), that portion of any plan which consists of a transfer of property described in § 83, that portion of any plan which consists of a trust to which § 402(b) applies, a qualified governmental excess benefit arrangement described in § 415(m), or that portion of any applicable employment retention plan described in § 457(f)(4).

Section 457(f)(1) provides that compensation under a nonqualified deferred compensation plan subject to § 457(f) is included in the gross income of the participant or beneficiary for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. Section 457(f)(3)(B) provides that the rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual. Any amount deferred under a § 457(f) plan that is not subject to a substantial risk of forfeiture (*i.e.*, a vested amount) is currently included in gross income (even if not actually or constructively received), and the amount subsequently paid or made available is taxed under § 72. See § 1.457–11(c).

Section 409A applies to ineligible nonqualified deferred compensation plans maintained by tax-exempt and governmental employers, as well as to nonqualified deferred compensation plans maintained by taxable employers. Section 409A generally provides that, unless certain requirements are met, amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. Section 409A(d)(4) provides that the rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

Section 409A does not apply to qualified plans (as defined under § 219(g)(5), without regard to subparagraph (A)(iii) thereof), eligible deferred compensation plans under § 457(b), or qualified governmental excess benefit arrangements described in § 415(m). See § 1.409A–1(a)(2). However, § 409A applies to nonqualified (ineligible) deferred compensation plans to which § 457(f) applies, separately and in addition to the requirements applicable to such plans under § 457(f). See § 1.409A–1(a)(4). Section 409A(c) provides that nothing in § 409A prevents the inclusion of amounts in gross income under any other provision of the Code or any other rule of law earlier than the time provided in § 409A. Section 409A(c) further provides that any amount included in gross income under § 409A is not required to be included in gross income under any other Code provision or any other rule of law later than the time provided in § 409A.

Final regulations under § 409A were published on April 10, 2007 (72 FR 19234) and generally become applicable January 1, 2008.[1] Those regulations provide guidance on when a separation pay plan (as defined in § 1.409A–1(m)) is treated as not providing for a deferral of compensation for purposes of § 409A. See § 1.409A–1(b)(9). The regulations also define a substantial risk of forfeiture for purposes of § 409A. See § 1.409A–1(d).

III. BONA FIDE SEVERANCE PAY PLANS UNDER § 457(e)(11)

The Treasury and the Service anticipate issuing guidance providing that an arrangement is a *bona fide* severance pay plan under § 457(e)(11), and thus is not subject to the requirements of § 457, if: (1) the benefit is payable only upon involuntary severance from employment, (2) the amount payable does not exceed two times the employee's annual rate of pay (taking into account only pay that does not exceed the maximum amount that may be taken into account under a qualified plan pursuant to § 401(a)(17) for the year in which the employee has a severance from em-

[1] For general and transition guidance regarding the application of § 409A, see Notice 2005–1, 2005–2 C.B. 274, and Notice 2006–79, 2006–43 I.R.B. 763. See also Notice 2006–100, 2006–51 I.R.B. 1109, which provides guidance to employers and payers on their reporting and wage withholding for calendar years 2005 and 2006 with respect to deferrals of compensation and amounts includible in gross income under § 409A.

ployment), and (3) the plan provides that the payments must be completed by the end of the employee's second taxable year following the year in which the employee separates from service. With respect to the requirement that benefits be payable only upon involuntary severance from employment, it is anticipated that the guidance would include exceptions for window programs, collectively bargained separation pay plans, and certain reimbursement or in-kind benefit arrangements (similar to the exceptions in § 1.409A–1(b)(9)(ii), (iv), and (v)).

IV. SUBSTANTIAL RISK OF FORFEITURE UNDER § 457(f)

The Treasury and the Service further anticipate issuing guidance regarding a substantial risk of forfeiture for purposes of § 457(f)(3)(B) under rules similar to those set forth under § 1.409A–1(d).

Section 1.409A–1(d) provides that a right to an amount of compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services or the occurrence of a condition that is related to a purpose of the compensation and the possibility of forfeiture is substantial. For this purpose, if a service provider's entitlement to the amount is conditioned on the occurrence of the service provider's involuntary separation from service without cause, the right is subject to a substantial risk of forfeiture if the possibility of forfeiture is substantial. An amount is not subject to a substantial risk of forfeiture merely because the right to the amount is conditioned, directly or indirectly, upon refraining from the performance of services. Further, as described in § 1.409A–1(d)(1), the addition of any risk of forfeiture after the right to the compensation arises, or any extension of a period during which compensation is subject to a risk of forfeiture (sometimes referred to as a "rolling risk of forfeiture"), is generally disregarded for purposes of determining whether such compensation is subject to a substantial risk of forfeiture under § 409A.

Section 1.409A–1(d)(1) provides that an amount is not considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the present value of the amount made subject to a risk of forfeiture is materially greater than the present value of the amount the recipient otherwise could have elected to receive absent such risk of forfeiture. This is because, absent tax considerations, a rational participant normally would not agree to subject a right to amounts that may be earned and payable as current compensation, such as salary payments, to a condition that subjects the right to the same payments to a real possibility of forfeiture. Accordingly, in this situation, agreement to subject the amount to a substantial risk of forfeiture indicates that the recipient of the compensation is confident that there is not a real risk of forfeiture and is only subjecting the amount to the purported risk of forfeiture as a means of avoiding taxation. Thus, amounts that an individual could have elected to receive under a salary deferral election generally cannot be made subject to a substantial risk of forfeiture under the rules of § 409A beyond the date or time the salary would otherwise have been received.

The Service and Treasury anticipate that upcoming guidance under § 457(f) will generally adopt the rules relating to substantial risk of forfeiture that are contained in § 1.409A–1(d).

As noted above, § 1.409A–1(d) provides that an amount of compensation is subject to a substantial risk of forfeiture if the entitlement to the amount is conditioned upon the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial. Section 1.409A–1(d) further provides that a condition related to a purpose of the compensation must relate to the service provider's performance for the service recipient or the service recipient's business activities or organizational goals (for example, the attainment of a prescribed level of earnings or equity value of completion of an initial public offering). Comments are requested on whether any special rules should apply for purposes of § 457(f) with respect to this aspect of the definition of a substantial risk of forfeiture, taking into account that state and local government and tax-exempt entities to which § 457(f) applies generally do not have business activities or organizational goals that are comparable to profit-making entities.

V. INTERACTION OF §§ 409A AND 457(f) UNDER ANTICIPATED STANDARDS

Under the rules at § 1.409A–1(b)(4)(i) relating to short-term deferrals, a deferral of compensation for purposes of § 409A does not occur if the plan under which a payment is made does not provide for a deferred payment and the service provider actually or constructively receives such payment on or before the first day of the applicable 2½ month period. Under § 1.409A–1(a)(4), the inclusion in income of an amount under § 457(f) is treated as a payment of the amount for purposes of the short-term deferral rule contained in § 1.409A–1(b)(4).

If the standard for a substantial risk of forfeiture for purposes of § 409A described in Part IV of this notice is adopted, a substantial risk of forfeiture under § 457(f)(1)(B) could not lapse later than the date the substantial risk of forfeiture lapsed under § 409A and § 1.409A–1(d). Accordingly, if a participant under an ineligible plan under § 457(f) included an amount of deferred compensation in gross income when it ceased to be subject to a substantial risk of forfeiture under § 457(f), the amount generally would not be subject to § 409A because the right to the amount and the payment would qualify as a short-term deferral under § 1.409A–1(a)(4). However, the right to earnings on amounts that have previously been included under § 457(f) would be deferred compensation for purposes of § 409A unless the right to the earnings independently satisfied the requirements for an exclusion from coverage under § 409A.

VI. EFFECTIVE DATE AND RELIANCE

The Treasury and the Service anticipate that the guidance described in this notice would be prospective. With respect to periods before such guidance is issued, no inference should be made from the anticipated guidance described in this notice regarding either the definition of a *bona fide* severance pay plan for purposes of § 457(e)(11)(A)(i) or the determination of substantial risk of forfeiture for purposes of § 457(f). However, pending the issuance of further guidance, taxpayers may rely on the definition of a *bona fide* sev-

erance pay plan in the anticipated guidance described in section III of this notice for purposes of § 457(e)(11)(A)(i) and the rules regarding a substantial risk of forfeiture in the anticipated guidance described in the first two paragraphs of section IV of this notice for purposes of § 457(f). Comments are specifically requested as to the extent to which transition guidance regarding the application of § 457(f) would be necessary and appropriate, and what such transition guidance would provide.

This notice does not affect the application of § 409A or the guidance thereunder, including the determination of whether a plan is subject to § 409A and the application of the transition guidance issued under § 409A.

VII. REQUEST FOR COMMENTS

Treasury and the Service intend to issue guidance reflecting the definitions of a *bona fide* severance pay plan for purposes of § 457(e) and substantial risk of forfeiture for purposes of § 457(f), as described in Parts III and IV of this notice. Comments regarding these definitions, and any related issues that should be addressed under § 457, are requested.

Written comments should be submitted by October 15, 2007. Send submissions to CC:PA:LPD:PR, (Notice 2007–62), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may also be hand delivered Monday through Friday between the hours of 8:30 a.m. and 4:00 p.m. to: Internal Revenue Service, CC:PA:LPD:PR, (Notice 2007–62), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. Alternatively, comments may be submitted via the Internet at *notice.comments@irscounsel.treas.gov* (Notice 2007–62). All comments will be available for public inspection.

VIII. DRAFTING INFORMATION

The principal author of this notice is Cheryl Press of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury and the Service participated in its development. For further information regarding this notice, contact Ms. Press at (202) 622–6060 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Deductions for Entertainment Use of Business Aircraft

REG–147171–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the use of business aircraft for entertainment. These proposed regulations affect taxpayers that deduct expenses for entertainment, amusement, or recreation provided to specified individuals. This document also provides notice of a public hearing on these proposed regulations. The proposed regulations reflect amendments under the American Jobs Creation Act of 2004 (AJCA) and the Gulf Opportunity Zone Act of 2005 (GOZA).

DATES: Written comments must be received by September 13, 2007. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for October 25, 2007, at 10 a.m., must be received by October 4, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–147171–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–147171–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments via the internet at the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–147171–05). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under section 274, Michael A. Nixon of the Office of Associate Chief Counsel (Income Tax & Accounting), (202) 622–4930; concerning the regulations under section 61, Lynne A. Camillo of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities), (202) 622–6040 (not toll-free numbers); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations under section 274(e)(2) of the Internal Revenue Code (Code). Section 274(e)(2) was amended by section 907 of the AJCA, Public Law 108–357, and by section 403(mm) of the GOZA, Public Law 109–135. Both amendments are effective for certain expenses incurred after October 22, 2004. On May 27, 2005, the IRS and Treasury Department issued Notice 2005–45, 2005–1 C.B. 1228, providing interim guidance on amended section 274(e)(2) and inviting comments. Notice 2005–45 is effective for expenses incurred after June 30, 2005. Commentators submitted written and electronic comments responding to Notice 2005–45. The IRS and Treasury Department have reviewed and considered all the comments in the process of preparing these proposed regulations. See §601.601(d)(2)(ii)(*b*) of this chapter.

Generally, section 162(a) allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under section 274(a)(1)(A), no deduction is allowed for an activity generally considered to be entertainment, amusement, or recreation, unless the taxpayer establishes that the activity is directly related to or (in certain cases) associated with the active conduct of the taxpayer's trade or business.

Section 1.274–2(b)(1) of the Income Tax Regulations provides that entertainment means any activity of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips. Similar activities relating solely to the taxpayer's family also may constitute entertainment. Entertainment may include an activity that satisfies the personal, living, or family needs of an individual, such as providing food and beverages or a hotel suite to a business customer or the customer's family. Entertainment does not include activities, however, that are clearly not regarded as constituting entertainment, such as the provision of supper money by an employer to an employee working overtime, the maintenance of a hotel room by an employer for lodging of an employee while in business travel status, or the use of an automobile in the active conduct of a trade or business even though also used for routine personal purposes such as commuting to and from work. Under §1.274–2(b)(1)(ii), an objective test is used to determine whether an activity is of a type generally considered to constitute entertainment.

Section 274(e) provides exceptions to the general disallowance provisions of section 274(a). Prior to amendment by the AJCA, section 274(e)(2) excepted expenses from section 274(a) "to the extent that the expenses are treated by the taxpayer" as compensation to the employee. Under prior law, section 274(e)(9) similarly excepted expenses to the extent that the expenses are treated by the taxpayer as income to persons who are not employees.

Section 274(o) provides that the Secretary shall prescribe regulations necessary to carry out the purposes of the section.

Generally, §1.61–21(b)(1) requires an employee to include in gross income the fair market value of a fringe benefit, such as an entertainment flight, after subtracting amounts paid, by or on behalf of the employee, for the fringe benefit, as well as amounts excluded from income by another section of the Code. If an employee takes a personal flight on an employer's aircraft, and the employer also provides a pilot, the general rule under §1.61–21(b)(6) is that

the fair market value of the flight is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight. If the employer does not provide a pilot, the general rule under §1.61–21(b)(7) is that the fair market value of the flight is equal to the amount that an individual would have to pay in an arm's-length transaction to rent a comparable aircraft for that period in the geographic area in which the aircraft is used. The regulations do not permit valuation of a flight by reference to the employer's costs.

As an alternative to the general valuation rules just described, §1.61–21(g) provides that an employee's personal flights on an employer's aircraft may be valued using an optional special valuation rule, the non-commercial flight valuation rule. In order to use the non-commercial flight valuation rule, applying the applicable aircraft multiple from §1.61–21(g)(7), it is necessary to know the weight of the employer's aircraft, the number of miles for the flight being valued, and whether the employee receiving the benefit is a control employee within the meaning of §1.61–21(g)(8) or (9). The value of an employee's personal use of a company aircraft is computed by multiplying the Standard Industry Fare Level (SIFL) by the terminal charge to arrive at the value of the flight (the SIFL formula). SIFL is a cents-per-mile factor that, taken with the aircraft multiple and the terminal charge, is intended to approximate coach and first class fares on commercial aircraft.

The consistency rule set forth in §1.61–21(g)(14)(i) provides that a taxpayer who uses the SIFL formula in a calendar year to value any flight provided to an employee must use the SIFL formula to value all flights provided to employees during that calendar year. Notice 2005–45 advised taxpayers that the consistency rule in the regulations would be amended to permit taxpayers to value the entertainment use of aircraft by specified individuals (within the meaning of section 274(e)(2)(B)) under the fair market value rules of §1.61–21(b) but continue to value flights for other employees and for specified individuals not traveling for entertainment purposes using the SIFL formula.

In *Sutherland Lumber-Southwest, Inc. v. Comm'r*, 114 T.C. 197 (2000), *aff'd* 255 F.3d 495 (8th Cir. 2001), *acq.* 2002–1 C.B. xvii, the Tax Court held that the amount a taxpayer may deduct for the cost of entertainment-related flights under the section 274(e)(2) exception is not limited to the amount included in the income of the employees and corporate officers who took the flights. Rather, the court held that a taxpayer may deduct the full cost of an employee's or officer's non-business flight on the taxpayer's aircraft if the taxpayer includes in the recipient's income the value of the flights computed under the non-commercial flight valuation rule of §1.61–21. As a result, a deduction greater than the amount included in the recipient's income was allowable.

Section 907 of the AJCA was intended to overturn *Sutherland Lumber* in certain cases. H.R. Conf. Rep. No. 108–755, at 798 (2004). Specifically, as amended by the AJCA, the section 274(e)(2) and (9) exceptions to the section 274(a) disallowance apply in the case of a specified individual only "to the extent that the expenses do not exceed the amount of expenses" that are treated as compensation to the specified individual. A specified individual is any individual who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 (15 U.S.C. section 78p(a)) with respect to the taxpayer, or who would be subject to those requirements if the taxpayer were an issuer of equity securities referred to in that section. Section 274(e)(2)(B).

Thus, in the case of a specified individual, the section 274(e)(2) and (9) disallowance exceptions apply only to the extent that a taxpayer treats as compensation to the specified individual an amount equal to or greater than the amount of deductible entertainment expenses allocable to entertainment provided to the specified individual. Expenses allocable to entertainment provided to the specified individual that the taxpayer does not treat as compensation to the specified individual are disallowed.

Explanation of Provisions and Summary of Comments

1. *Definition of Entertainment*

a. *Distinction between entertainment and other personal use*

Notice 2005–45 references §1.274–2(b)(1) in defining entertainment. Commentators suggested that the proposed regulations should provide additional guidance on the meaning of "entertainment" in order to assist taxpayers in delineating between entertainment use and "nonentertainment" personal use. The proposed regulations do not adopt these comments because these rules are addressed in the existing regulations at §1.274–2(b)(1). Consistent with those regulations, entertainment does not include travel for reasons such as attending to business other than that of the employer, medical purposes, attending funerals, and participating in charitable activities.

b. *Primary purpose test*

Several commentators recommended that the proposed regulations adopt a purpose of the flight test that would characterize a flight as a business flight for all purposes if the primary purpose of the flight is business. Thus, under the recommendation, if the primary purpose of the flight were business, no amount would be disallowed for entertainment provided to specified individuals who are traveling for entertainment purposes. Conversely, if the primary purpose of the flight were entertainment, no amount would be allowed as an expense deduction with respect to individuals traveling for business. The proposed regulations do not adopt these comments. The IRS and Treasury Department believe that disregarding entertainment use by a specified individual would be contrary to Congressional intent in amending section 274(e)(2) to disallow expenses allocable to entertainment use of aircraft by specified individuals. Section 274(e)(2)(B) focuses on the recipient of the entertainment, amusement, or recreation, not the purpose of the employer providing the entertainment or the overall use of the aircraft.

c. *Use of aircraft for bona fide security purposes*

Several commentators suggested that entertainment use by a specified individual of an aircraft should not be treated as entertainment within the meaning of section 274 or subject to section 274(e)(2)(B) if there is a business need to use the aircraft to provide security, pursuant to §1.132–5(m). The proposed regulations do not adopt this comment. Section 1.132–5(m) merely computes the income inclusion for a fringe benefit. It reduces the income inclusion amount rather than eliminates it. It does not convert entertainment flights into business flights.

2. *Definition of Expenses*

a. *Fixed costs*

To calculate the amount of expenses for entertainment use of an aircraft, Notice 2005–45 provides that taxpayers must take into account all of the expenses of maintaining and operating the aircraft. Commentators recommended that entertainment expenses should not include fixed costs such as depreciation. Commentators noted that the legislative history refers to "aircraft operating costs" and "actual cost" and interpreted this language to mean that costs should be limited to variable costs. H. Conf. Rept. 108–755 at 798. Some commentators have suggested that incremental costs are the only costs that should be disallowed.

The proposed regulations do not adopt these comments. Industry use of the term "operating costs" generally refers to all costs, fixed and variable, including depreciation claimed on the taxpayer's tax return. Therefore, the IRS and Treasury Department believe that the use of the term "operating costs" in the legislative history does not reflect Congressional intent to apply section 274(e)(2) to variable costs only. Moreover, the term "aircraft operating costs" in the legislative history is consistent with use of that term in *Sutherland Lumber*, in which it referred to fixed and variable costs for purposes of section 274(e)(2).

b. *Depreciation*

Commentators suggested that disallowing accelerated depreciation (including the additional first-year depreciation under, for example, sections 168(k), 1400L(b), and 1400N(d)) would result in excessive amounts disallowed in early years and is inconsistent with Congressional intent to provide incentives for purchasing aircraft. In response to these comments, the proposed regulations permit a taxpayer to elect to calculate depreciation on a straight-line basis over the class life of an aircraft for all of the taxpayer's aircraft for the current year and all future years when calculating the amount of disallowed expenses.

c. *Aggregation of aircraft*

Notice 2005–45 permits taxpayers to calculate expenses separately for each aircraft or to aggregate the expenses of aircraft of similar cost profiles. For example, the expenses of turboprop aircraft may be aggregated (but may not be aggregated with the expenses of a jet aircraft) and the expenses of a two-engine jet aircraft may be aggregated (but may not be aggregated with the expenses of a four-engine jet aircraft).

Commentators requested that the proposed regulations provide more details on the definition of cost profile. In response to these comments, the proposed regulations provide additional characteristics that define similar cost profiles. Specific comments are requested on the appropriateness of these characteristics in defining similar cost profiles and on other characteristics that may be useful in determining criteria for aggregating aircraft.

3. *Allocation Methods*

Notice 2005–45 provides an occupied seat hour or mile formula to allocate expenses to entertainment flights provided to specified individuals. The formula multiplies the hours or miles flown by an aircraft by the number of occupied seats. Then a taxpayer aggregates all fixed and variable expenses to determine the total expenses paid or incurred during the taxable year with respect to an aircraft (or aggregated aircraft) and divides the amount of total expenses by total occupied seat hours or miles to determine the cost per occupied seat hour or mile. Once a taxpayer determines this cost, the taxpayer uses the cost to determine the expenses allocable to each specified individual's entertainment flight.

Commentators expressed concern that this formula may not produce accurate results and is administratively burdensome. The proposed regulations retain the occupied seat hour or mile formula, which allows averaging of fixed and variable costs and yields a simple formula for determining the cost of one occupied seat hour or mile. It does not require a determination of whether a flight is for entertainment of specified individuals or other uses or an allocation of entertainment and other costs for a particular flight. Once the taxpayer determines the cost per occupied seat hour or mile, the disallowance calculation is relatively easy and results in a cost for each occupied seat hour or mile allocable to each entertainment flight taken by a specified individual.

Nevertheless, in response to commentators' concerns, the proposed regulations provide the option of allocating expenses on a flight-by-flight basis as an alternative to using the occupied seat mile or hour formula. Under the flight-by-flight method, a taxpayer may aggregate all expenses for the taxable year and divide the amount of total expenses by the number of flight hours or miles for the taxable year to determine the cost per hour or mile. The taxpayer allocates expenses to each flight by multiplying the number of miles or hours for the flight by the expense per hour or mile and allocates expenses for the flight to the passengers on the flight per capita.

4. *Specified Individuals*

Notice 2005–45 applies to entertainment use of an aircraft provided to a specified individual of a taxpayer by a party related to the taxpayer within the meaning of sections 267(b) or 707(b). The notice also defines a specified individual as the recipient of entertainment provided to a spouse or family member of the specified individual or to another person because of the person's relationship to the specified individual, cf. §1.61–21(a)(4), and includes those entertainment flights within the potential disallowance of costs to the taxpayer. Commentators expressed concern that these provisions defined specified individual too broadly, exceeding the authority of the IRS and Treasury Department, and suggested that the definition be narrowed.

The proposed regulations do not adopt these comments. In the GOZA, Congress enacted technical corrections that clarify that the related party rules of sections 267(b) and 707(b) apply to section 274(e)(2). The IRS and Treasury Department conclude that Congress intended all entertainment flights to be subject to the section 274(e)(2) requirements. However, comments on how the regulations could define passengers aboard by virtue of a relationship with a specified individual are welcome. Finally, the proposed regulations define *officer* by reference to regulations at 17 CFR §240.16a–1(f) that implement section 16(a) of the Securities Exchange Act of 1934.

5. *Other*

a. *Determination of basis*

The proposed regulations provide that, if an amount disallowed is allocable to depreciation, §1.274–7 applies and the basis of the aircraft is not reduced for the amount of depreciation disallowed.

b. *Allocation of expenses pro rata*

Numerous commentators inquired how taxpayers should allocate disallowed expenses between fixed and variable expenses. In response to these comments, the proposed regulations provide that the expense disallowance provisions apply to expenses on a *pro rata* basis.

c. *Deadhead flights*

Notice 2005–45 provides that an aircraft returning empty from a flight after discharging passengers or traveling empty to pick up passengers (deadheading) is treated as having the same number and character of occupied seat hours or miles as the leg or legs of the trip on which passengers are aboard.

Commentators, citing confusion on the treatment of deadhead flights, have requested additional guidance, including safe harbors such as treating the empty flight as if it had the same composition as the prior or subsequent flight. The proposed regulations adopt these comments by providing more detail on how taxpayers should treat deadhead flights.

d. *Leasing of taxpayer aircraft*

Commentators requested guidance on the leasing of aircraft to unrelated third parties. In response to these requests, the proposed regulations provide guidance on the treatment of expenses allocable to taxpayers that charter their aircraft.

e. *Aircraft as entertainment facilities*

Notice 2005–45 addressed the treatment of expenses for the entertainment use of aircraft and did not address the effect of the amendment to section 274(e)(2) on the treatment of aircraft as entertainment facilities. Commentators asked how the entertainment facility disallowance under section 274(a)(1)(B) interacts with rules on aircraft used to provide specified individuals with entertainment.

Section 274(a)(1)(B) disallows all the expenses, direct and indirect, associated with the ownership and operation of an aircraft that is an entertainment facility, except for expenses for business travel and expenses that meet the exceptions of section 274(e). Thus, expenses for personal, nonentertainment travel (such as for medical purposes or attending funerals), as well as for entertainment travel, are disallowed, unless an exception such as 274(e)(2) applies.

The IRS and Treasury Department believe that Congress, in adding section 274(e)(2)(B), contemplated entertainment use of aircraft by specified individuals without specifically considering circumstances in which aircraft may be regarded as entertainment facilities. Therefore, these proposed regulations are limited to use of taxpayer-provided aircraft in entertainment activities under section 274(a)(1)(A), and do not provide rules relating to the application of section 274(e)(2)(B) in circumstances under which aircraft may be regarded as entertainment facilities under section 274(a)(1)(B). Comments are requested on whether the IRS and Treasury Department should issue guidance on aircraft as entertainment facilities and the content of the guidance.

f. *Fringe benefit consistency rules*

The proposed regulations relax the consistency rule of §1.61–21(g)(14)(i) to permit taxpayers to value the entertainment use of aircraft by specified individuals under the fair market value rules of §1.61–21(b), but continue to value flights for other employees and for specified individuals not traveling for entertainment using either the SIFL formula of §1.61–21(g) or the general (fair market value) rule of §1.61–21(b).

The proposed regulations preserve the consistency rule of §1.61–21(g)(14)(i) with respect to particular groups of employees (specified and non-specified individuals) and with respect to non-entertainment flights. Thus, if an employer values the entertainment use of aircraft by one specified individual under the fair market value rules of §1.61–21(b) in a calendar year, the employer must use the fair market value rules to value the entertainment use of aircraft by all specified individuals during that calendar year.

The existing consistency rules of §1.61–21(g)(14)(i) continue to apply for valuing the entertainment use of aircraft for other employees (non-specified individuals) and for valuing the personal use of aircraft by specified individuals not traveling for entertainment purposes. Thus, if an employer values the personal use of aircraft by any other employee or the non-entertainment personal use of aircraft by any specified individual using the SIFL formula of §1.61–21(g) in a calendar year, the employer must use the SIFL formula to value the personal use of aircraft by all other employees and the non-entertainment personal use of aircraft by all specified individuals during that calendar year. Similarly, if the employer values the personal use of aircraft by any other employee or the non-entertainment personal use of aircraft by any specified individual using the fair market value rules of §1.61–21(b) in a calendar year, the employer must use the fair market value rules to value the personal use of aircraft by all other employees and the non-entertainment personal use of aircraft by all specified individuals during that calendar year.

g. *Treatment as compensation to non-specified individuals*

The proposed regulations clarify that in order for a taxpayer to meet the requirements of section 274(e)(2) for expenses

treated as compensation, the taxpayer must include the proper amount as compensation to an employee on the taxpayer's return.

h. *Section 162(m)*

Notice 2005–45 provides that any amount for the entertainment use of an aircraft that is treated by the taxpayer as compensation to a specified individual who is also a covered employee is subject to section 162(m). Commentators disagreed with this conclusion. They opined that the deduction disallowance of section 274 relates to the expenses of the aircraft, not amounts treated as income to the employee, and that, under §1.162–25T, the expenses associated with providing the aircraft are not deducted by the employer as compensation. Thus, according to the commentators, expenses treated as compensation for purposes of section 274(e)(2) should not be subject to the deduction limitation of section 162(m). However, the IRS and Treasury Department believe that the deduction limitation of section 162(m) applies to amounts treated as compensation for purposes of section 274(e)(2). The legislative history of section 162(m) provides that the deduction limitation of section 162(m) applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash regardless of whether the remuneration is deducted as compensation. H.R. Conf. Rep. No. 103–213 (1993) at 585 (1993–3 C.B. 463). Any amount included in an employee's income for entertainment flights is remuneration for services and therefore is subject to section 162(m).

i. *Entertainment sold to customers*

Commentators requested clarification on whether section 274(e)(8), the exception to section 274(a) for entertainment sold to customers, applies to a taxpayer's expenses for providing an aircraft for the entertainment use of specified individuals. A commentator asserted that section 274(e)(8) excepts expenses of a flight from the section 274(a) disallowance to the extent a passenger pays full and fair consideration. The commentator suggested that expenses are excepted from the section 274(a) disallowance under section 274(e)(8) in three circumstances common in business aviation: (1) a lease of an aircraft without a pilot at a fair market value lease rate; (2) payment of a fair market value charter rate for an aircraft the taxpayer has enrolled under a charter certificate held by a charter company; and (3) payment of expenses allowed to be reimbursed in a time-sharing agreement under Federal Aviation Regulation 91.501(d), 14 CFR 91.501(d).

The proposed regulations do not address these issues, as rules implementing the section 274(e)(8) exception are provided in §1.274–2(f)(2)(ix). Therefore, it is outside the scope of these proposed regulations on the exceptions under section 274(e)(2) and (9). As stated in §1.274–2(f)(2)(ix), section 274(e)(8) applies only to taxpayers that are in the trade or business of providing entertainment to customers, and only to entertainment sold to customers. Therefore, the exception does not apply to expenses paid or incurred for entertainment provided to individuals by taxpayers that are not in the trade or business of providing entertainment.

j. *Charter Rate Safe Harbor*

As an alternative to determining actual expenses, the IRS and Treasury Department are considering whether the regulations should permit taxpayers to determine the amount of their expenses paid or incurred for entertainment flights by reference to charter rates. Under such a safe harbor, taxpayers could elect to treat as the amount of expenses for entertainment flights an undiscounted charter rate for each flight in lieu of calculating the actual expenses of each entertainment flight provided to specified individuals. Under the safe harbor, the undiscounted charter rate for the flight would be allocated to the individuals on the flight in lieu of the occupied seat or flight-by-flight allocation methods.

Under the charter rate method being considered, an undiscounted charter rate would be based on the amount that a person would pay in an arms-length transaction to charter the same or comparable aircraft for the same or comparable flight. A taxpayer would have to show that a charter rate used to value flights is a substantiated actual, published, undiscounted charter rate charged to the general public within 10 days before or after the taxpayer's flight by a qualified chartering company. A qualified chartering company would be a chartering company unrelated to the taxpayer (within the meaning of section 267(b) or 707(b)) that is in the trade or business of chartering aircraft and that operates and charters 10 or more aircraft to the general public during the taxable year. Leaseback arrangements or rates charged for off-peak usage, aircraft downtime, or by employers to their employees would not qualify under the safe harbor. A qualified chartering company would not include a chartering company that charters any aircraft to or for the use of a person (or an employee of the person) that owns any aircraft used by the chartering company. If a taxpayer elects the safe harbor, the taxpayer would have to use it for all entertainment flights on all of the taxpayer's aircraft for the current and all subsequent taxable years unless the taxpayer makes a proper revocation.

The proposed regulations do not include the safe harbor. Nonetheless, comments are requested on whether such a safe harbor, or other safe harbors, should be adopted. Comments are also requested on the availability of substantiated actual, published, undiscounted charter rates charged to the general public by companies that meet the requirements of a qualified chartering company.

Taxpayers may not use a charter rate to determine expenses allocable to entertainment flights unless and until a rule is adopted in final regulations.

Proposed Effective Date

The regulations, as proposed, apply to any taxable year beginning on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, taxpayers may rely on the rules in these proposed regulations or those provided in Notice 2005–45 for taxable years beginning before the publication of the Treasury decision. If Notice 2005–45 and the proposed regulations include different rules for the same particular issue, then the taxpayer may rely on either the rule set forth in Notice 2005–45 or the rule set forth in the proposed regulations. However, if the proposed regulations include a rule that was not included in Notice 2005–45, taxpayers may not rely on the absence of a

rule in Notice 2005–45 to apply a rule contrary to the proposed regulations.

Special Analyses

This notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for October 25, 2007, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter through the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

Drafting Information

The principal authors of these proposed regulations are Michael A. Nixon and Christian T. Wood of the Office of Associate Chief Counsel (Income Tax & Accounting) and Lynne A. Camillo of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.274–9 also issued under 26 U.S.C. 274(o).* * *

Section 1.274–10 also issued under 26 U.S.C. 274(o).* * *

Par. 2. Section 1.61–21 is amended by revising paragraphs (g)(14)(i) and (ii) and adding paragraph (g)(14)(iii) to read as follows:

§1.61–21 Taxation of fringe benefits.

* * * * *

(g) * * *

(14) * * *

(i) *Use by employer.* Except as otherwise provided in paragraph (g)(13) or paragraph (g)(14)(iii) of this section or in §1.132–5(m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employer to value any flight provided in a calendar year, the rule must be used to value all flights provided to all employees in the calendar year.

(ii) *Use by employee.* Except as otherwise provided in paragraph (g)(13) or (g)(14)(iii) of this section or in §1.132–5(m)(4), if the non-commercial flight valuation rule of this paragraph (g) is used by an employee to value a flight provided by an employer in a calendar year, the rule must be used to value all flights provided to the employee by that employer in the calendar year.

(iii) *Exception for entertainment flights provided to specified individuals after October 22, 2004.* Notwithstanding the provisions of paragraph (g)(14)(i) of this section, an employer may use the general valuation rules of §1.61–21(b) to value the entertainment use of an aircraft by a specified individual. An employer who uses the general valuation rules of §1.61–21(b) to value any entertainment use of an aircraft by a specified individual in a calendar year must use the general valuation rules of §1.61–21(b) to value all entertainment use of aircraft provided to all specified individuals during that calendar year.

(A) *Specified individuals defined.* For purposes of paragraph (g)(14)(iii) of this section, *specified individual* is defined in section 274(e)(2)(B) and §1.274–9(b).

(B) *Entertainment defined.* For purposes of paragraph (g)(14)(iii) of this section, *entertainment* is defined in §1.274–2(b)(1).

* * * * *

Par. 3. Section 1.274–9 is added to read as follows:

§1.274–9 Entertainment provided to specified individuals.

(a) *In general.* No deduction is allowed for expenses for entertainment provided to a specified individual (as defined in paragraph (b) of this section) except to the extent that the expenses do not exceed the amount of the expenses treated as compensation to the specified individual, as provided in section 274(e)(2)(B) and (9) and §1.274–10. The amount disallowed is reduced by any amount that the specified individual reimburses a taxpayer for the entertainment.

(b) *Specified individual defined.* (1) A specified individual is an individual who is subject to section 16(a) of the Securities Act of 1934 with respect to the taxpayer, or an individual who would be subject to section 16(a) if the taxpayer were an issuer of equity securities referred to in that section. Thus, for example, a specified individual is an officer, director, or more than 10 percent owner of a corporation taxed under subchapter C or subchapter S, or a personal service corporation. A specified individual includes every individual who—

(i) Is the direct or indirect beneficial owner of more than 10 percent of any class of any registered equity (other than an exempted security);

(ii) Is a director or officer of the issuer of the security;

(iii) Would be the direct or indirect beneficial owner of more than 10 percent of any class of a registered security if the tax-

payer were an issuer of equity securities; or

(iv) Is comparable to an officer or director of an issuer of equity securities.

(2) For partnership purposes, a specified individual includes any partner that holds more than a 10 percent equity interest in the partnership, or any general partner, officer, or managing partner of a partnership.

(3) For purposes of this section, *officer* has the same meaning as in 17 C.F.R. §240.16a–1(f).

(4) A specified individual includes a director or officer of a tax-exempt entity.

(5) A specified individual of a taxpayer includes a specified individual of a party related to the taxpayer within the meaning of section 267(b) or section 707(b).

(6) For purposes of section 274(a), a specified individual is treated as the recipient of entertainment provided to a spouse or family member of the specified individual or to another individual because of the relationship of the spouse, family member or other individual to the specified individual. Thus, expenses allocable to entertainment provided to the spouse, family member, or other individual are attributed to the specified individual for purposes of determining the amount of disallowed expenses.

(c) *Entertainment use of aircraft by specified individuals.* For rules relating to entertainment use of aircraft by specified individuals, see §1.274–10.

(d) *Effective/applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.274–10 is added to read as follows:

§1.274–10 Special rules for aircraft used for entertainment.

(a) *Use of an aircraft for entertainment*—(1) *In general.* Under section 274(a) and this section, no deduction otherwise allowable under chapter 1 is allowed for expenses for the use of a taxpayer-provided aircraft for entertainment, except as provided in paragraph (a)(2) of this section.

(2) *Exceptions*—(i) *In general.* Paragraph (a)(1) of this section does not apply to deductions for expenses for business entertainment air travel or to deductions for expenses that meet the exceptions of section 274(e), §1.274–2(f), and this section.

(ii) *Expenses treated as compensation*—(A) *Employees.* Section 274(a), paragraphs (a) through (d) of §1.274–2, and paragraph (a)(1) of this section, in accordance with section 274(e)(2), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to employees to the extent that a taxpayer—

(*1*) Properly treats the expenses with respect to the recipient of entertainment as compensation to an employee under chapter 1 and as wages to the employee for purposes of chapter 24; and

(*2*) Includes the proper amount in the employee's income under §1.61–21.

(B) *Persons who are not employees.* Section 274(a), paragraphs (a) through (e) of §1.274–2, and paragraph (a)(1) of this section, in accordance with section 274(e)(9), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to persons who are not employees to the extent the expenses are includible in the income of those persons. This exception does not apply to any amount paid or incurred by the taxpayer that is required to be included in any information return filed by the taxpayer under part III of subchapter A of chapter 61 and is not so included.

(C) *Specified individuals.* Section 274(a) and paragraphs (a) through (d) of §1.274–2, in accordance with section 274(e)(2)(B), do not apply to expenses for entertainment air travel of a specified individual to the extent that the expenses do not exceed the sum of—

(*1*) The amount treated as compensation under paragraph (a)(2)(ii)(A) of this section or reported as income under paragraph (a)(2)(ii)(B) of this section to the specified individual; and

(*2*) Any amount the specified individual reimburses the taxpayer.

(b) *Definitions.* The definitions in this paragraph (b) apply for purposes of this section.

(1) *Entertainment.* For the definition of entertainment for purposes of this section, see §1.274–2(b)(1). Entertainment does not include personal travel that is not for entertainment purposes. For example, travel to attend a family member's funeral is not entertainment.

(2) *Entertainment air travel.* Entertainment air travel is any travel aboard a taxpayer-provided aircraft for entertainment purposes.

(3) *Business entertainment air travel.* Business entertainment air travel is any entertainment air travel aboard a taxpayer-provided aircraft that is directly related to the active conduct of the taxpayer's trade or business or related to an expenditure directly preceding or following a substantial and *bona fide* business discussion and associated with the active conduct of the taxpayer's trade or business. See §1.274–2(a)(1)(i) and (ii). Air travel is not business entertainment air travel merely because a taxpayer-provided aircraft is used for the travel as a result of a *bona fide* security concern under §1.132–5(m).

(4) *Taxpayer-provided aircraft.* A taxpayer-provided aircraft is any aircraft owned by, leased to, or chartered to, a taxpayer or any party related to the taxpayer (within the meaning of section 267(b) or section 707(b)).

(5) *Specified individual.* For rules relating to the definition of a specified individual, see §1.274–9.

(c) *Amount disallowed.* The amount disallowed under this section for an entertainment flight by a specified individual is the amount of expenses allocable to the entertainment flight of the specified individual under paragraph (e)(2)(ii)(D), (e)(3)(ii), or (f)(3) of this section, reduced (but not below zero) by the amount the taxpayer treats as compensation under paragraph (a)(2)(ii)(A) of this section or reports as income under paragraph (a)(2)(ii)(B) of this section to the specified individual, plus any amount the specified individual reimburses the taxpayer.

(d) *Expenses taken into account under this section*—(1) *Definition of expenses.* In determining the amount of expenses taken into account under this section, a taxpayer must take into account all of the expenses of operating the aircraft, including all fixed and variable expenses the taxpayer deducts in the taxable year. These expenses include, but are not limited to, salaries for pilots, maintenance personnel, and other personnel assigned to the aircraft; meal and lodging expenses of flight personnel; take-off and landing fees; costs

for maintenance flights; costs of on-board refreshments, amenities and gifts; hangar fees (at home or away); management fees; costs of fuel, tires, maintenance, insurance, registration, certificate of title, inspection, and depreciation; and all costs paid or incurred for aircraft leased, or chartered, to or by the taxpayer.

(2) *Leases or charters to third parties.* Expenses allocable to a lease or charter of a taxpayer's aircraft to an unrelated third-party in a *bona-fide* business transaction for adequate and full consideration are not taken into account for purposes of the definition of expenses in paragraph (d)(1) of this section. Only expenses allocable to the charter period are not taken into account under this paragraph (d)(2).

(3) *Straight-line method permitted for determining depreciation disallowance under this section*—(i) *In general.* In lieu of the amount of depreciation deducted in the taxable year, solely for purposes of paragraph (d)(1) of this section, a taxpayer may elect to treat as its depreciation deduction the amount that would result from using the straight-line method of depreciation over the class life (as defined by section 168(g)(2) and taking into account the applicable convention under section 168(d)) of an aircraft, although the taxpayer uses another methodology to calculate depreciation for the aircraft under other sections of the Internal Revenue Code (for example, section 168). If the property is qualified property or 50-percent bonus depreciation property under section 168(k), qualified New York Liberty Zone property under section 1400L(b), or qualified Gulf Opportunity Zone property under section 1400N(d), depreciation for purposes of this straight-line election is determined on the unadjusted depreciable basis of the property. For purposes of this section, a taxpayer that elects to use the straight-line method and class life under this paragraph (d)(3) for any aircraft it operates must use that method for all taxpayer-provided aircraft it operates and must continue to use the method for the entire period the taxpayer uses any taxpayer-provided aircraft.

(ii) *Aircraft placed in service in earlier taxable years.* If the taxpayer elects to use this paragraph (d)(3) with respect to aircraft placed in service in taxable years before the current taxable year, the amount of depreciation is determined by applying the straight-line method of depreciation to the original cost (or, for property acquired in an exchange to which section 1031 applies, the basis of the aircraft as determined under section 1031(d)) and over the class life (taking into account the applicable convention under section 168(d)) of the aircraft as though the taxpayer used that methodology from the year the aircraft was placed in service.

(iii) *Manner of making and revoking election.* A taxpayer makes the election under this paragraph (d)(3) by filing an income tax return for the taxable year that determines the taxpayer's expenses for purposes of paragraph (d)(1) of this section by including depreciation as determined under this paragraph (d)(3). An election may be revoked only for compelling circumstances upon consent of the Commissioner by private letter ruling.

(4) *Aggregation of aircraft*—(i) *In general.* A taxpayer may aggregate the expenses of aircraft of similar cost profiles for purposes of calculating disallowed expenses under paragraph (c) of this section.

(ii) *Similar cost profiles.* Aircraft are of similar cost profiles if their operating costs per mile or per hour of flight are comparable. Aircraft must have the same engine type (jet or propeller) and the same number of engines to have similar cost profiles. Other factors to be considered in determining whether aircraft have similar cost profiles include, but are not limited to, payload, passenger capacity, fuel consumption rate, age, maintenance costs, and depreciable basis.

(e) *Allocation of expenses*—(1) *General rule.* For purposes of determining the expenses allocated to entertainment air travel of a specified individual under paragraph (a)(2)(ii)(C) of this section, a taxpayer must use either the occupied seat hours or miles method of paragraph (e)(2) of this section or the flight-by-flight method of paragraph (e)(3) of this section. A taxpayer must use the chosen method for all flights of all aircraft for the taxable year.

(2) *Occupied seat hours or miles method*—(i) *In general.* The occupied seat hours or miles method determines the amount of expenses allocated to a particular entertainment flight of a specified individual based on the occupied seat hours or miles for an aircraft for the taxable year. Under this method, a taxpayer may choose to use either occupied seat hours or miles for the taxable year to determine the amount of expenses allocated to entertainment flights of specified individuals, but must use occupied seat hours or miles consistently for all flights for the taxable year.

(ii) *Computation of the occupied seat hours or miles method.* The amount of expenses allocated to an entertainment flight taken by a specified individual is determined under the occupied seat hours or miles method by—

(A) Determining the total expenses for the year under paragraph (d)(1) of this section for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable;

(B) Determining the total number of occupied seat hours or miles for the taxable year for the aircraft or group of aircraft by totaling the occupied seat hours or miles of all flights in the taxable year flown by the aircraft or group of aircraft, as applicable. The occupied seat hours or miles for a flight is the number of hours or miles flown for the flight multiplied by the number of seats occupied on that flight. For example, a flight of six hours with three passengers results in 18 occupied seat hours;

(C) Determining the cost per occupied seat hour or mile for the aircraft or group of aircraft, as applicable, by dividing the total expenses in paragraph (e)(2)(ii)(A) of this section by the total number of occupied seat hours or miles determined in paragraph (e)(2)(ii)(B) of this section; and

(D) Determining the amount of expenses allocated to an entertainment flight taken by a specified individual by multiplying the number of hours or miles of the flight by the cost per occupied hour or mile for that aircraft or group of aircraft, as applicable, as determined in paragraph (e)(2)(ii)(C) of this section.

(iii) *Allocation of expenses of multi-leg trips involving both business and entertainment legs.* A taxpayer that uses the occupied seat hours or miles allocation method must allocate the expenses of a trip by a specified individual that involves at least one segment for business and one segment for entertainment purposes between the business travel and the entertainment travel unless none of the expenses for the entertainment segment are disallowed. The entertainment cost of a multi-leg trip is the total cost of the flights

(by occupied seat hours or miles) over the cost of the flights that would have been taken without the entertainment segment or segments.

(iv) *Examples.* The following examples illustrate the provisions of this paragraph (e)(2):

Example 1. (i) A taxpayer-provided aircraft is used for Flights 1, 2, and 3, of 5 hours, 5 hours, and 4 hours, respectively, during the Taxpayer's taxable year. On Flight 1, there are four passengers, none of whom are specified individuals. On Flight 2, passengers A and B are specified individuals traveling for entertainment purposes and passengers C and D are not specified individuals. Taxpayer treats $1,200 as compensation to A, and B reimburses Taxpayer $500. On Flight 3, all four passengers (A, B, E, and F) are specified individuals traveling for entertainment purposes. The Taxpayer treats $1,300 each as compensation to A, B, E, and F. Taxpayer incurs $56,000 in expenses for the operation of the aircraft for the taxable year. The aircraft is operated for 56 occupied seat hours for the period (four passengers times 5 hours or 20 occupied seat hours for Flight 1, plus four passengers times 5 hours or 20 occupied seat hours for Flight 2, plus four passengers times 4 hours or 16 occupied seat hours for Flight 3). The cost per occupied seat hour is $1,000 ($56,000/56 hours).

(ii) For purposes of determining the amount disallowed (to the extent not treated as compensation or reimbursed), $5,000 ($1,000 X 5 hours) each is allocable with respect to A and B for Flight 2, and $4,000 ($1,000 X 4 hours) each is allocable with respect to A, B, E, and F for Flight 3.

(iii) For Flight 2, because Taxpayer treats $1,200 as compensation to A, and B reimburses Taxpayer $500, Taxpayer may deduct $1,700 of the cost of Flight 2 allocable to A and B. The deduction for the remaining $8,300 cost allocable to entertainment provided to A and B on Flight 2 is disallowed (with respect to A, $5,000 less the $1,200 treated as compensation, and with respect to B, $5,000 less the $500 reimbursed).

(iv) For Flight 3, because Taxpayer treats $1,300 each as compensation to A, B, E, and F, Taxpayer may deduct $5,200 of the cost of Flight 3. The deduction for the remaining $10,800 cost allocable to entertainment provided to A, B, E, and F on Flight 3 is disallowed ($4,000 less the $1,300 treated as compensation to each specified individual).

Example 2. (i) G, a specified individual, is the sole passenger on an aircraft on a two-hour flight from City A to City B for business purposes. G then travels on a three-hour flight from City B to City C for entertainment purposes, and returns from City C to City A on a four-hour flight. G's flights have resulted in nine occupied seat hours (two for the first segment, plus three for the second segment, plus four for the third segment). If G had returned directly to City A from City B, the flights would have resulted in four occupied seat hours.

(ii) Under paragraph (e)(2)(iii) of this section, five occupied seat hours are allocable with respect to G's entertainment (nine total occupied seat hours minus the four occupied seat miles that would have resulted if the travel had been a roundtrip business trip without the entertainment segment). If Taxpayer's cost per occupied seat hour for the year is $1,000, $5,000 is allocated with respect to G's entertainment use of the aircraft ($1,000 X five occupied seat hours). The amount disallowed is $5,000 minus any amount the Taxpayer treats as compensation to G or that G reimburses Taxpayer.

(3) *Flight-by-flight method*—(i) *In general.* The flight-by-flight method determines the amount of expenses allocated to a particular entertainment flight of a specified individual on a flight-by-flight basis by allocating expenses to individual flights and then to a specified individual traveling for entertainment purposes on that flight.

(ii) *Allocation of expenses.* A taxpayer using the flight-by-flight method must aggregate all expenses (as defined in paragraph (d)(1) of this section) for the taxable year for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable, and divide the total amount of expenses by the number of flight hours or miles for the taxable year for that aircraft or group of aircraft, as applicable, to determine the cost per hour or mile. Expenses are allocated to each flight by multiplying the number of miles or hours for the flight by the cost per hour or mile. The expenses for the flight are then allocated to the passengers on the flight per capita. Thus, if three of five passengers are traveling for business and two passengers are specified individuals traveling for entertainment purposes, and the total expense allocated to the flight is $10,000, the expense allocable to each specified individual is $2,000.

(f) *Special rules*—(1) *Determination of basis.* If an amount disallowed is allocable to depreciation under paragraph (f)(2) of this section, the rules of §1.274–7 apply. In that case, the basis of an aircraft is not reduced for the amount of depreciation disallowed under this section.

(2) *Pro rata disallowance.* The expense disallowance provisions of this section are applied on a *pro rata* basis to all of the expenses disallowed by this section.

(3) *Deadhead flights.* (i) For purposes of this section, an aircraft returning without passengers after discharging passengers or flying without passengers to pick up passengers (deadheading) is treated as having the same number and character of passengers as the leg of the trip on which passengers are aboard for purposes of the allocation of expenses under paragraphs (e)(2) or (e)(3) of this section. For example, when an aircraft travels from point A to point B and then back to point A, and one of the legs is a deadhead flight, for determination of disallowed expenses, the aircraft is treated as having made both legs of the trip with the same passengers aboard for the same purposes.

(ii) When a deadhead flight does not occur within a roundtrip flight, but occurs between two unrelated flights involving more than two destinations (such as an occupied flight from point A to point B, followed by a deadhead flight from point B to point C, and then an occupied flight from point C to point A), the allocation of passengers and expenses to the deadhead flight occurring between the two occupied trips is based on the number of passengers on board for the two occupied legs of the flight, the character of the passengers on board (entertainment or nonentertainment purpose) and the length in hours or miles of the two occupied legs of the flight.

(g) *Effective/applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 14, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 15, 2007, 72 F.R. 33169)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Exclusions From Gross Income of Foreign Corporations

REG–138707–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9332) that modify final regulations issued under section 883(a) and (c) of the

Internal Revenue Code (Code), relating to income derived by foreign corporations from the international operation of ships or aircraft. Those regulations revise §1.883–3 of the final regulations, relating to the treatment of controlled foreign corporations, following the repeal of section 954(a)(4) and (f) (foreign base company shipping provisions) by section 415 of the American Jobs Creation Act of 2004. In addition, those regulations provide guidance for foreign corporations organized in countries that provide an exemption from taxation solely through an income tax convention, and amend certain provisions in the current section 883 regulations. The text of those regulations serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by September 24, 2007. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, October 24, 2007, at 10 a.m. must be received by Monday, September 24, 2007.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–138707–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–138707–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–138707–06).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Patricia A. Bray, at (202) 622–3880; concerning submissions of comments and/or requests for a hearing, Kelly Banks, at (202) 622–0392 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)), and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1667.

Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by August 24, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in §§1.883–2(f), 1.883–3(c) and (d), and 1.883–4(e). This information is required to enable a foreign corporation to determine if it is eligible to exclude its income from the international operation of ships or aircraft from gross income on its U.S. Federal income tax return. This information will also enable the IRS to monitor compliance with the provisions of the proposed regulations with respect to the stock ownership requirements of §1.883–1(c)(2), and to make a preliminary determination of whether the foreign corporation is eligible to claim such an exemption and is accurately reporting income.

The collections of information are mandatory. The likely respondents are foreign corporations engaged in the international operation of ships or aircraft that wish to claim an exemption from U.S. tax under section 883, and certain of their shareholders owning (directly or indirectly) a majority of the value of the shares of such corporations.

Estimated total annual reporting/recordkeeping burden on foreign corporations: 1200 hours.

The estimated annual burden per respondent varies from 0 minutes to 3 hours, depending on the circumstances of the foreign corporation, with an estimated average of one hour.

Estimated number of respondents: 1,200.

Estimated annual frequency of responses: once.

Estimated total annual reporting burden on shareholders: 925 hours.

The estimated annual burden per respondent varies from 1 minute to one hour, depending on the circumstances of the shareholder or intermediary, with an estimated average of 30 minutes.

Estimated number of respondents: 1850.

Estimated annual frequency of shareholder or intermediary responses: once every three years if no information changes and once a year if a change in ownership information occurs.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend 26 CFR part 1. Those regulations amend the income inclusion test in §1.883–3 of the final regulations issued in T.D. 9087, 2003–2 C.B. 781 [68 FR 51394]. Those regulations also address a number of comments that have

been received concerning other portions of the final section 883 regulations. The text of those regulations serves as the text of these regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a significant number of U.S. small entities. This certification is based on the fact that these regulations apply solely to foreign corporations, and impose only a limited collection of information burden on shareholders of such corporations, which in some cases may include U.S. small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 24, 2007, beginning at 10 a.m. in the IRS Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by September 24, 2007, and an outline of the topics to be discussed and the time devoted to each topic (a signed original and eight (8) copies) by September 24, 2007. A period of 10 minutes will be allocated to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Patricia A. Bray of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.883–0 is amended by revising the entries for §§1.883–1(g)(3) and (h)(3), 1.883–2(e)(2), 1.883–3, and 1.883–5(d) and (e) to read as follows:

§1.883–0 Outline of major topics.

* * * * *

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(g) * * *

(3) [The text of the proposed entry for §1.883–1(g)(3) is the same as the text of the entry for §1.883–1T(g)(3) published elsewhere in this issue of the Bulletin].

* * * * *

(h) * * *

(3) * * *

(i) through (iv) [The text of the proposed entries for §1.883–1(h)(3)(i) through (iv) is the same as the text of the entries for §1.883–1T(h)(3)(i) through (iv) published elsewhere in this issue of the Bulletin].

* * * * *

§1.883–2 Treatment of publicly traded corporations.

* * * * *

(e) * * *

(2) [The text of the proposed entry for §1.883–2(e)(2) is the same as the text of the entry for §1.883–2T(e)(2) published elsewhere in this issue of the Bulletin].

* * * * *

§1.883–3 Treatment of controlled foreign corporations.

* * * * *

[The text of the proposed entry for §1.883–3 is the same as the entry for §1.883–3T published elsewhere in this issue of the Bulletin].

§1.883–5 Effective/applicability dates.

* * * * *

(d) and (e) [The text of the proposed entries for §1.883–5(d) and (e) is the same as the text of the entries for §1.883–5T(d) and (e) published elsewhere in this issue of the Bulletin].

Par. 3. Section 1.883–1 is amended by revising paragraphs (c)(3)(i)(D), (c)(3)(i)(G), (c)(3)(i)(H), (c)(3)(i)(I), (c)(3)(ii), (g)(1)(ix), (g)(1)(x), (g)(1)(xi), (g)(3), (h)(1)(ii), and (h)(3) to read as follows:

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(D) [The text of the proposed amendment to §1.883–1(c)(3)(i)(D) is the same as the text of §1.883–1T(c)(3)(i)(D) published elsewhere in this issue of the Bulletin].

* * * * *

(G) through (I) [The text of the proposed amendments to §1.883–1(c)(3)(i)(G) through (I) is the same as the text of §1.883–1T(c)(3)(i)(G) through (I) published elsewhere in this issue of the Bulletin].

(ii) [The text of the proposed amendment to §1.883–1(c)(3)(ii) is the same as the text of §1.883–1T(c)(3)(ii) published elsewhere in this issue of the Bulletin].

* * * * *

(g) * * *

(1) * * *

(ix) through (xi) [The text of the proposed amendments to §1.883–1(g)(1)(ix) through (xi) is the same as the text of §1.883–1T(g)(1)(ix) through (xi) published elsewhere in this issue of the Bulletin].

* * * * *

(3) [The text of the proposed amendment to §1.883–1(g)(3) is the same as the text of §1.883–1T(g)(3) published elsewhere in this issue of the Bulletin].

* * * * *

(h) * * *

(1) * * *

(ii) [The text of the proposed amendment to §1.883–1(h)(1)(ii) is the same as the text of §1.883–1T(h)(1)(ii) published elsewhere in this issue of the Bulletin].

(2) * * *

(3) [The text of the proposed amendment to §1.883–1(h)(3) is the same as the text of §1.883–1T(h)(3) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 4. Section 1.883–2 is amended by revising paragraphs (e)(2), (f)(3), and (f)(4)(ii) to read as follows:

§1.883–2 Treatment of publicly–traded corporations.

* * * * *

(e) * * *

(2) [The text of the proposed amendment to §1.883–2(e)(2) is the same as the text of §1.883–2T(e)(2) published elsewhere in this issue of the Bulletin].

(f) * * *

(3) [The text of the proposed amendment to §1.883–2(f)(3) is the same as the text of §1.883–2T(f)(3) published elsewhere in this issue of the Bulletin].

(4) * * *

(ii) [The text of the proposed amendment to §1.883–2(f)(4)(ii) is the same as the text of §1.883–2T(f)(4)(ii) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 5. Section 1.883–3 is revised to read as follows:

§1.883–3 Treatment of controlled foreign corporations.

[The text of this proposed section is the same as the text of §1.883–3T published elsewhere in this issue of the Bulletin].

Par. 6. Section 1.883–4 is amended by revising paragraphs (d)(4)(i)(C), (d)(4)(i)(D), (e)(2), and (e)(3) to read as follows:

§1.883–4 Qualified shareholder stock ownership test.

* * * * *

(d) * * *

(4) * * *

(i) * * *

(C) and (D) [The text of the proposed amendments to §1.883–4(d)(4)(i)(C) and (D) is the same as the text of §1.883–4T(d)(4)(i)(C) and (D) published elsewhere in this issue of the Bulletin].

* * * * *

(e) * * *

(2) and (3) [The text of the proposed amendments to §1.883–4(e)(2) and (3) is the same as the text of §1.883–4T(e)(2) and (3) published elsewhere in this issue of the Bulletin].

Par. 7. Section 1.883–5 is amended by revising paragraphs (d) and (e) to read as follows:

§1.883–5 Effective/applicability dates.

* * * * *

(d) [The text of the proposed amendment to §1.883–5(d) is the same as the text of §1.883–5T(d) published elsewhere in this issue of the Bulletin].

(e) [The text of the proposed amendment to §1.883–5(e) is the same as the text of §1.883–5T(e) published elsewhere in this issue of the Bulletin].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 25, 2007, 72 F.R. 34650)

Foundations Status of Certain Organizations

Announcement 2007–67

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

30815 Community Development Corporation, Inc., Hephzibah, GA
Abdur Rahim Memorial Community Project, Inc., Baltimore, MD
Abundance Ministries, Baton Rouge, LA
Acction, Inc., Baltimore, MD
Affordable Homes of Hampton Roads, Inc., Chesapeake, VA
Affordable Housing Real Estate Company, Shafter, CA
A G A P E Enterprises, Inc., Orlando, FL
Agroforestry Council International, Galveston, TX
All About Animals, Inc., San Angelo, TX
Allan D. Wapner Community Foundation, Ontario, CA
Allegany Council for the Arts, Inc., Belmont, NY
Amber Alert Foundation of Louisiana, Baton Rouge, LA

American Bosnian Center, Hayward, CA
American Children Across the Pacific, Gardena, CA
American Southeast Asian Literary & Educational Counseling, Inc., Lowell, MA
American Vietnamese Writers Artists Association, Inc., Sacramento, CA
Americans for Child Care Fighting Poverty a Not for Profit, Miami Beach, FL
Angels Touch Outreach Parental Services, San Jose, CA
Anointed Hands Ministries, Greensboro, NC
Aparem Foundation Corporation, Downey, CA
APEX Educational Institute, Inc., Rancho Cucamonga, CA
Ashley Foundation, Chicago, IL
Begin Again Ministry, Inc., Lynchburg, VA
Bethlehem Community Development Center, Woodbury, NJ
Big Fun in the Son Social Service Center, Parma, OH
Both Parents Matter, Inc., Pittsboro, NC
Boys & Girls Club of Hillsboro Texas, Inc., Hillsboro, TX
Brookshire Health Care, Inc., Atlanta, GA
California School Employees Association Institute for Public Education, San Jose, CA
Campus Community Services, Inc., Huntington Beach, CA
Careervision, Inc., Santa Barbara, CA
CEDI, St. Louis, MO
Center for Research in Vocational Education, Fremont, CA
Center of Excellence in Rural and Minority Health, Inc., Columbia, SC
Changing Faces Community CFC, Sauk Rapids, MN
Chinese-American Foundation for Youth Enrichment, Mineola, NY
Christian Medical College Alumni Association, Inc., Shreveport, LA
Christian Stewardship Ministries, Inc., Mitchellville, MD
Church of Jesus Christ Ministries, West Mifflin, PA
Cleveland Performing Arts Ministries, Inc., Chesterland, OH
Community Based Learning Solutions, Coronado, CA
Community Health Initiatives Center, Inc., Brooklyn, NY
Community Housing and Empowerment Connection, Inc., Newark, DE
Community Resources for Growth, Erie, PA
Community Services Enterprise, Spanaway, WA
Community Wellness Institute, Inc., Pittsburgh, PA
Conscious Action, Larkspur, CA
Crying in the Wilderness Church Ministries, Palmetto, GA
Crystal City Housing Education and Training Corporation, Crystal City, TX
Cuda One, Harlingen, TX
Cultural Connections International, Inc., Bellvale, NY
Daviess County Rural Housing Finance Corporation, Washington, IN
Delissa Development Corporation, Natchez, MS
Deliverance Tabernacle Economic Development, Inc., Pensacola, FL
Digital Volunteers, Inc., Washington, DC
Dolomite Royal Towers, Inc., Dolomite, AL
Dove Connection Ministries, San Diego, CA
Downtown Overland Park Foundation, Inc., Overland Park, KS
Eartha M M White Historical Museum, Inc., Jacksonville, FL
ED4U2, Little Rock, AZ
Empowerment Services, Inc., New Rochelle, NY
Endless Imagination Production Company, Incorporated, Los Angeles, CA
Extreme Sports Philanthropy Organization, Flint, MI
Ezras Chaveirim, Spring Valley, NY
Faith Visionary Services, Oakland, CA
Faiths Place Foundation, Chicago, IL
Family Education & Spiritual Center, Inc., St. Louis, MO
FCT Broken Wings, Inc., Oakland Park, FL
First Preferred Care, Inc., Jacksonville, FL
Foster City Reserve Police Officers Association, Foster City, CA
Foundation for Responsible Citizenry, Edmond, OK
Foundation for Sustainable Development With Human Values, Inc., Washington, DC
Foundation to Empower Marriage, Inc., Winter Springs, FL
Friends Enrichment Programs, Inc., Huntsville, AL
Friends of Justice in Hampshire County, Inc., Leeds, MA
Friends of the Homeless, Chicago, IL
Gberaga Community Development Corporation, Dallas, TX
Genesis Addiction Prevention Programs, Inc., Auburn, CA
George Washington Leadership Foundation, Columbia, SC
Global Friendship Mission, Inc., Everett, WA
Global Intercultural Guide-GIG, Olympia, WA
Good Faith Network, Inc., El Paso, TX
Good Start, Irving, TX
Gospel Music Hall of Fame Museum Foundation, Philadelphia, PA
Gospel Testimonial Ministries, Inc., Birmingham, AL
Greater Faith Housing Corporation, Buffalo, NY
Greenville Dream Center, Pelzer, SC
Grog Show, Inc., North Las Vegas, NV
Growing Season Ranch, Lyle, WA
Habakkuk Outreach Center, Inc., Franklin, VA
Harmony Homes, Inc., Bowling Green, OH
Healthy Images Producing Hope Opportunity and Prosperity, Inc., Cleveland, OH
Healthyliving Foundation, Inc., Jupiter, FL
Help The Blind American Fund, Incorporated, Centerport, NY
Helping Out Poverty Environments (H.O.P.E.) Community Development Corporation, Stockton, CA
Holy Tabernacle of Deliverance CDC, Inc., Columbus, OH
Housing for Appalachia People, Inc., Jonesville, VA
In Good Hands Ministry for Creative Arts and Spiritual Growth, Inc., Glen Cove, NY
Ineglect, Inc., Dickinson, TX
Inner City Excel Community Learning Center, Leavenworth, KS
International All-Ukrainian Charitable Foundation, Inc., Bronx, NY
International Basketball Association, Washington, DC
International Creole & Cajun Cultural Association, Church Point, LA
International Fibrosis Foundation, Inc., Little Rock, AR

International University Bremen Foundation of America, Inc., Boston, MA
International Womens Fellowship, Cary, NC
Invision Foundation, Inc., Clarkston, GA
Iry D. & Gwendolyn Herbert Life Enrichment Center, Incorporated, Riviera Beach, FL
Izzy Moving Dance Theatre, Covington, LA
Jail Ministries and Outreaches, Inc., Palatka, FL
JC Community Services, Incorporated, Mebane, NC
Jefferson County Junior Golf Association, Dandridge, TN
Joy of the Lord Community, Canton, MI
JTA Community Project, Inc., College Park, GA
Kingdom Work Enterprise, Inc., Canton, OH
Kingston Regional Senior Living Corp., Lake Katrine, NY
Laney-Walker Safe Haven Foundation, Inc., Augusta, GA
LCL Reintegration Institute, Midwest City, OK
L D M Wings of Eagles Ministries, Graham, NC
Le Collectif Trait D Union, Inc., Lanham, MD
Lewis Ministries, Inc., Columbus, GA
Liberty Community Development Corporation, Inc., Canton, MS
Life Stage Theatrical Troupe, Inc., Bowling Green, OH
Life Work Community Development Center, Detroit, MI
Living Faith Outreach, Inc., Norfolk, VA
Living Running Wells of Life International Outreach Ministries, Whittier, CA
Lofty Ideals, Inc., Florence, MS
Los Angeles Latino Diabetes Coalition, Los Angeles, CA
L O S T Lifeline Organized Search Teams, Clyde, OH
Low Income Family Training, Inc., Culver City, CA
MAC Resource & Transitional Center, Inc., Euclid, OH
Mahoney Research Library, Minden, LA
Marine Watch International, San Francisco, CA
Mars Exploration Learning Center, Isabella, PA
Medication Compliance Institute, Lakeside, CA
Miami Dade Community Services, Inc., Miami, FL
Michigan City Economic Development Foundation, Inc., Michigan City, IN
Midway Community Development Corporation, Midway, FL
Millennium Minds, Inc., Queens, NY
Mission of Hope 2000, Inc., New Hyde Park, NY
M & M Education and Training Center, Inc., Las Vegas, NV
Mount Moriah Outreach Ministries, Inc., Jackson, TN
Name Above All, Inc., Moncks Corner, SC
National Endowment for the Christian Arts, Inc., Fort Washington, MD
Naturopathic Medical Association of California, Anaheim, CA
New Beginning Group Home, Inc., Houston, TX
New Birth Ministries, Inc., Norfolk, VA
New Covenant Community Center, Inc., Bath, SC
New Foundation, Corona, CA
New Foundation Outreach Ministries, Inc., Thibodaux, LA
Next Step Mentoring Agency, Oklahoma City, OK
North Coast Humanities Council, Bayside, CA
Northside Women Outreach Center, Lake Charles, LA
Northwest Hereditary Disease Foundation, Everett, WA
Novasia, Inc., Memphis, TN
Nu Yu Enterprises, Inc., Brookline, MA
OIC Community Revitalization, Incorporated, Philadelphia, PA
One Hope, Fort Worth, TX
O T Transportation, Inc., Atco, NJ
Pamaque Clan of Coahuila Y Tejas Spanish Colonial Indian Missions, San Antonio, TX
Peace Education, Arlington, TX
People With Pride of Michigan, Inc., Riverside, CA
Phoenix Rising Tarot, Inc., Los Angeles, CA
Pilgrim House Productions, Inc., Los Angeles, CA
Polar Bear Communications Corporation, Dillingham, AK
Polk County Chamber of Commerce Foundation, Livingston, TX
Pony Angels, Inc., Carmel, CA
Power House Outreach Ministries, Inc., Horn Lake, MS
Prashanti Bhavan, Inc., Lake Mary, FL
Programs for Girls, Inc., Middleborough, MA
Project Outreach Unlimited, Inc., Omaha, NE
Project Youth, Inc., Lawndale, CA
Rainbow Children's Truss, Inc., Jonesboro, GA
Refuge & Educational Measures for Success & Publishing, Inc., Houston, TX
Renaissance Educational Services, Inc., San Bernardino, CA
Reproductive Counseling for Youth, Inc., Benowa Waters, Australia
Resistance International, Washington, DC
Retirement Clubs of New Jersey, Inc., Elizabeth, NJ
Rivers of Faith Ministries, Holly Springs, MS
Rocky Boy Health Board, Box Elder, MT
Rosewood Center for Wholeness, Columbia, SC
Sabine Community Health Center, Inc., Many, LA
Saginaw County Fatherhood Initiative Organization, Saginaw, MI
Salt of the Earth Outreach Ministries, East Hazel Crest, IL
San Diego Urban Economic Corporation, San Diego, CA
San Jose-Silicon Valley Center for Entrepreneurial Development, San Jose, CA
Saphires House, Ypsilanti, MI
Savy Education Services, Inc., Atlanta, GA
Send Home a Reading Experience, Inc., Windsor, VT
S F Pickwick, Baytown, TX
Sheila's Wish Foundation, Daytona Beach, FL
Show Them We Care STWC, Potomac, MD
Skills Building Training Centers of America, New Orleans, LA
Smile Foundation, Inc., Weatherford, TX
Southeastern Housing and Development Corporation, Miami, FL
Southern Wis. Mounted Search and Rescue, Mineral Point, WI
Southside Christian Charities, Inc., Jacksonville, FL
Street Light Ministries, Melrose, FL
Sunny Jordan Foundation, Shawnee, KS

Supporters of the Fleming County Public Library, Flemingsburg, KY
Sword of the Spirit Drug Outreach Center, Inc., New Orleans, LA
Tallapoosa Cornerstone, Inc., Tallapoosa, GA
Team Verox Group, Inc., Wilmington, DE
Thompson Land Development Nonprofit Housing Corporation, Detroit, MI
Top Hat Dancers, Inc., Canyon Country, CA
Trinity Liquidation Corporation, Inc., Cedartown, GA
Trinity Outreach, Decatur, GA
Trinity Village Foundation, Inc., Daphne, AL
True Fact Ministry, Altadena, CA
Trumpbours Corners Farm Museum, Saugerties, NY
Twisted Sister, Inc., Norman, OK
Unity Foundation International, Dayton, OH
Unity Housing Development Fund Corporation, Rochester, NY
Universal Research Publishing & Marketing, Inc., Southfield, MI
Uplift, Inc., Washington, DC
Upper Savannah Community Economic Development Corp., Greenwood, SC
Valley Mission Aviation, Inc., Broadway, VA
Veteran Connection, Akron, OH
Vidalia Choice Childcare, Inc., Vidalia, LA
Village Project, Sacramento, CA
Vine City Community Outreach Community Development Corporation, Atlanta, GA
Vision is Now, Inc., Cincinnati, OH
Vision Properties, Bolingbrook, IL
Wayne County Enrichment & Fitness Center, Goldsboro, NC
We Do Our Best At Recovery, Inc., 12 Steps, Baltimore, MD
Wesley Community Development Corporation, Houston, TX
West African Health Initiatives, Evanston, IL
White Star Horse Rescue & Rehabilitation, Mayfield, KY
Whitestone Village Revitalization Local Development Corp., Whitestone, NY
Woptura Medicine Society, Austin, TX
Wu-Kah-Ki Theatre Workshop, Newark, NJ
Zero2 Foundation, Matthews, NC
Zorya, Incorporated, Cos Cob, CT

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Application of Section 409A to Nonqualified Deferred Compensation Plans; Correction

Announcement 2007–68

AGENCY: Internal Revenue Service (IRS), Treasury.

SUMMARY: This document contains corrections to final regulations (T.D. 9321, 2007–19 I.R.B. 1123) that were published in the **Federal Register** on Tuesday, April 17, 2007 (73 FR 19234), relating to section 409A.

DATES: This correction is effective April 17, 2007.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney, (202) 622–9639 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under section 409A of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9321) contain errors that may prove misleading and are in need of correction.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 9321), which were the subject of FR Doc. 07–1820, is corrected as follows:

1. On page 19235, column 3, in the preamble the paragraph heading III. the language “Definition of Nonqualified Deferred Compensation Plan”, is corrected to read “Definition of Deferral of Compensation”.

2. On page 19243, column 1, in the preamble, paragraph E., the last sentence in the first paragraph, the language “The final regulations adopt this suggestion, so long as the risk of forfeiture to which the stock is subject constitutes a substantial risk of forfeiture for purposes of section 409A.” is corrected to read “The final regulations adopt this suggestion.”.

3. On page 19243, column 2, paragraph G., line 2 from the bottom of the paragraph, the language “Q&A–7 and section II.E. of the preamble” is corrected to read “Q&A–7 and sections II.E. and VI.E. of the preamble.”.

4. On page 19247, column 2, in the preamble, lines 3 and 4 from the bottom of the last paragraph, the language “limited period of time not to exceed one year following the initial existence of” is corrected to read “limited period of time not to exceed two years following the initial existence of”.

5. On page 19258, column 2, in the preamble the tenth line from the bottom of the column, the language “average level of *bona fide* service” is corrected to read “average level of *bona fide* services”.

6. On page 19264, column 1, in the preamble, paragraph D., line 9 from the bottom of the first paragraph, the language “with section 409A if the service” is corrected to read “with section 409A only if the service”.

7. On page 19264, column 2, in the preamble, paragraph D., the last sentence of the top paragraph, the language “For a discussion of the ability to provide for different times and forms of payment due to different types of separations from service, including separations from service due to certain disabilities, see section VII.C. 4 of this preamble.” is removed.

8. On page 19265, column 1, in the preamble under paragraph G., the third sentence of the paragraph, the language “The final regulations clarify that for these purposes, the availability of payments due to the unforeseeable emergency under any

other nonqualified deferred compensation plan as defined for purposes of section 409A, including plans that would be nonqualified deferred compensation plans for purposes of section 409A except due to the effective date of the statute, or under any qualified plan (including any assets available by obtaining a loan under a qualified plan), need not be considered in determining whether an emergency is or may be relieved through other means." is corrected to read "The final regulations clarify that for these purposes, the availability of payments under any qualified plan (including any amount available by obtaining a loan under a qualified plan), or under any other nonqualified deferred compensation plan due to the unforeseeable emergency, including plans that would be nonqualified deferred compensation plans for purposes of section 409A except due to the effective date of the statute, need not be considered in determining whether an emergency is or may be relieved through other means.".

9. On page 19265, column 1, in the preamble under paragraph G., lines 1 through 5 from the bottom of the first paragraph, the language "qualified plan, from a grandfathered nonqualified deferred compensation plan, or from another nonqualified deferred compensation plan that is subject to section 409A." is corrected to read "qualified plan, or from another nonqualified deferred compensation plan (including a grandfathered plan) due to the unforeseeable emergency.".

10. On page 19267, column 2, in the preamble under paragraph B., lines 4 and 5 from the bottom of the column, the language "Where the change in control event consists of an asset purchase, the" is corrected to read "Solely for purposes of this rule, the".

11. On page 19270, column 2, in the preamble under paragraph A., lines 2, 3, and 4 from the top of the paragraph, the language "contributions, each up to the section 402(g) dollar limit on elective deferrals, are separate, additive limits and are not" is corrected to read "contributions is subject to two separate, additive limits and not".

12. On page 19272, column 1, in the preamble, the paragraph heading of paragraph XII., the language "Effective Date of Final Regulations" is corrected to read "Applicability Date of Final Regulations".

13. On page 19272, column 2, in the preamble under paragraph B., line 2, the language "effective January 1, 2008. For periods" is corrected to read "applicable January 1, 2008. For periods".

14. On page 19272, column 2, in the preamble, paragraph B., line 7 from the top of the first paragraph, the language "relief for periods before the effective" is corrected to read "relief for periods before the applicability".

15. On page 19272, column 2, in the preamble, paragraph B., line 3 from the top of the second paragraph, the language "becoming effective January 1, 2008, on" is corrected to read "becoming applicable January 1, 2008, on".

16. On page 19272, column 2, in the preamble, paragraph C., line 5 from the top of the paragraph, the language "rights issued before the effective date of" is corrected to read "rights issued before the applicability date of".

17. On page 19273, column 1, in the preamble, paragraph C., line 13 from the top of the second paragraph, the language "2005) or on or before the effective date" is corrected to read "2005) or on or before the applicability date".

18. On page 19273, column 1, in the preamble, paragraph C., line 16 from the bottom of the paragraph, the language "effective date of the regulations. In" is corrected to read "applicability date of the regulations. In".

19. On page 19273, column 2, in the preamble, paragraph D., line 4 of the second paragraph, the language "established before the effective date of" is corrected to read "established before the applicability date of".

20. On page 19273, column 2, in the preamble, paragraph E., line 7 of the first paragraph, the language "the time such regulations were effective." is corrected to read "the time such regulations were applicable.".

Guy R. Traynor,
Federal Register Liaison,
Publications & Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
Procedure & Administration).

(Filed by the Office of the Federal Register on July 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2007, 72 F.R. 38477)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

26 CFR 1.42–14: Allocation rules for post-1989 State housing credit ceiling amounts.

Guidance is provided to state housing credit agencies of qualified states that request an allocation of unused housing credit carryover under section 42(h)(3)(D) of the Internal Revenue Code. See Rev. Proc. 2007-55, page 354.

Section 6404.—Abatements

26 CFR 301.6404–4T: Listed transactions and undisclosed reportable transactions (temporary).

T.D. 9333

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Application of Section 6404(g) of the Internal Revenue Code Suspension Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 6404(g)(2)(E) of the Internal Revenue Code on the suspension of any interest, penalty, addition to tax, or additional amount with respect to listed transactions or undisclosed reportable transactions. The temporary regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998, the American Jobs Creation Act of 2004, the Gulf Opportunity Zone Act of 2005, the Tax Relief and Health Care Act of 2006, and the Small Business and Work Opportunity Tax Act of 2007. The temporary regulations provide guidance to individual taxpayers who have participated in listed transactions or undisclosed reportable transactions. The text of the temporary regulations also serves as the text of the proposed regulations (REG–149036–04) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on June 21, 2007.

Applicability Date: These regulations apply to interest relating to listed transactions and undisclosed reportable transactions accruing before, on, or after October 3, 2004.

FOR FURTHER INFORMATION CONTACT: Stuart Spielman, (202) 622–7950 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Procedure and Administration Regulations (26 CFR part 301) by adding rules under section 6404(g) relating to the suspension of interest, penalties, additions to tax, or additional amounts with respect to listed transactions or undisclosed reportable transactions. Section 3305 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 685, 743) (RRA 98), added section 6404(g) to the Code, effective for taxable years ending after July 22, 1998. Section 6404(g) generally suspends interest and certain penalties if the IRS does not contact a taxpayer regarding possible adjustments to the taxpayer's liability within a specified period of time. Section 903(c) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418, 1652) (AJCA), excepted from the general interest suspension rules any interest, penalty, addition to tax, or additional amount with respect to a listed transaction or an undisclosed reportable transaction, effective for interest accruing after October 3, 2004. Section 303 of the Gulf Opportunity Zone Act of 2005, Public Law 109–135 (119 Stat. 2577, 2608–09) (GOZA), modified the effective date of the exception from the suspension rules for certain listed and reportable transactions. Section 426(b) of the Tax Relief and Health Care Act of 2006, Public Law 109–432 (120 Stat. 2922, 2975), provided a technical correction regarding the authority to exercise the "reasonably and in good faith" exception to the effective date rules. Section 8242 of the Small Business and Work Opportunity Tax Act of 2007, Public Law 110–28 (121 Stat. 190, 200), extended the current eighteen-month period within which the IRS can, without suspension of interest, contact a taxpayer regarding possible adjustments to the taxpayer's liability to thirty-six months, effective for notices provided after November 25, 2007.

Explanation of Provisions

If an individual taxpayer files a Federal income tax return on or before the due date for that return (including extensions), and if the IRS does not timely provide a notice to that taxpayer specifically stating the taxpayer's liability and the basis for that liability, then the IRS must suspend any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return that is computed by reference to the period of time the failure continues and that is properly allocable to the suspension period. A notice is timely if provided before the close of the eighteen-month period (thirty-six month period, in the case of notices provided after November 25, 2007) beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions. The suspension period begins on the day after the close of the eighteen-month period (or thirty-six month period) and ends twenty-one days after the IRS provides the notice. This suspension rule applies separately with respect to each item or adjustment. If, on or after December 21, 2005, a taxpayer provides to the IRS an amended return or other signed written document showing an additional tax liability, then the eighteen-month period (or thirty-six month period) does not begin to run with respect to the items that gave rise to the additional tax liability until that return or other signed written document is provided to the IRS.

The general rule for suspension does not apply to any interest, penalty, addition to tax, or additional amount relating

to any reportable transaction with respect to which the requirement of section 6664(d)(2)(A) is not met or a listed transaction as defined in section 6707A(c). This exception applies to interest accruing after October 3, 2004. With respect to interest relating to listed transactions or undisclosed reportable transactions accruing on or before October 3, 2004, the general rule for suspension applies only to (1) a participant in a settlement initiative, (2) a taxpayer acting reasonably and in good faith, or (3) a closed transaction. A *participant in a settlement initiative* is a taxpayer who, as of January 23, 2006, was participating in a settlement initiative described in IRS Announcement 2005–80, 2005–2 C.B. 967 (see §601.601(d)(2)(ii)(*b*)); or had entered into a settlement agreement under Announcement 2005–80 or any other prior or contemporaneous settlement initiative either formally published or directly communicated to taxpayers known to have participated in a tax shelter promotion. A *taxpayer acting reasonably and in good faith* is a taxpayer who the IRS determines has acted reasonably and in good faith, taking into account all the facts and circumstances surrounding a transaction. A *transaction* is a "closed transaction" if, as of December 14, 2005, the assessment of all federal income taxes for the taxable year in which the tax liability to which the interest relates is prevented by the operation of any law or rule of law. A transaction is also a closed transaction if a closing agreement under section 7121 has been entered into with respect to the tax liability arising in connection with the transaction.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. A regulatory assessment is therefore not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Stuart Spielman of the Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR Part 301 is amended as follows:

PART 301 PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6404–0T is added to read as follows:

§301.6404–0T Table of contents (temporary).

This section lists the paragraphs contained in §301.6404–4T.

§301.6404–4T Listed transactions and undisclosed reportable transactions (temporary).

(a) [Reserved].

(b)(1) through (b)(4) [Reserved].

(5) Listed transactions and undisclosed reportable transactions.

(i) In general.

(ii) Effective dates.

(iii) Special rule for certain listed or undisclosed reportable transactions.

(A) Participant in a settlement initiative.

(*1*) Participant in a settlement initiative who as of January 23, 2006, had not reached agreement with the IRS.

(*2*) Participant in a settlement initiative who, as of January 23, 2006, had reached agreement with the IRS.

(B) Taxpayer acting in good faith.

(*1*) In general.

(*2*) Presumption.

(*3*) Examples.

(C) Closed transactions.

Par. 3. Section 301.6404–4T is added to read as follows:

§301.6404–4T Listed transactions and undisclosed reportable transactions (temporary).

(a) [Reserved].

(b)(1) through (4) [Reserved].

(5) *Listed transactions and undisclosed reportable transactions*—(i) *In general.* The general rule of suspension under section 6404(g)(1) does not apply to any interest, penalty, addition to tax, or additional amount with respect to any listed transaction as defined in section 6707A(c) or any undisclosed reportable transaction. For purposes of this section, an *undisclosed reportable transaction* is a reportable transaction described in the regulations under section 6011 that is not adequately disclosed under those regulations and that is not a listed transaction. Whether a transaction is a listed transaction or an undisclosed reportable transaction is determined as of the date the IRS provides notice to the taxpayer regarding that transaction that specifically states the taxpayer's liability and the basis for that liability.

(ii) *Effective/applicability dates.* (A) These regulations apply to interest relating to listed transactions and undisclosed reportable transactions accruing before, on, or after October 3, 2004.

(B) The applicability of these regulations expires on or before June 18, 2010.

(iii) *Special rule for certain listed or undisclosed reportable transactions.* With respect to interest relating to listed transactions and undisclosed reportable transactions accruing on or before October 3, 2004, the exception to the general rule of interest suspension will not apply to a taxpayer who is a participant in a settlement initiative with respect to that transaction, to any transaction in which the taxpayer has acted reasonably and in good faith, or to a closed transaction. For purposes of this special rule, a "participant in a settlement initiative," a "taxpayer acting in good faith," and a "closed transaction" have the following meanings:

(A) *Participant in a settlement initiative*—(*1*) *Participant in a settlement initiative who, as of January 23, 2006, had not reached agreement with the IRS.* A *participant in a settlement initiative* includes a

taxpayer who, as of January 23, 2006, was participating in a settlement initiative described in Internal Revenue Service Announcement 2005–80, 2005–2 C.B. 967. See §601.601(d)(2)(ii)(b) of this chapter. A taxpayer participates in the initiative by complying with Section 5 of the announcement. A taxpayer is not a participant in a settlement initiative if, after January 23, 2006, the taxpayer withdraws from or terminates participation in the initiative, or the IRS determines that a settlement agreement will not be reached under the initiative within a reasonable period of time.

(*2*) *Participant in a settlement initiative who, as of January 23, 2006, had reached agreement with the IRS*. A *participant in a settlement initiative* is a taxpayer who, as of January 23, 2006, had entered into a settlement agreement under Announcement 2005–80 or any other prior or contemporaneous settlement initiative either offered through published guidance or, if the initiative was not formally published, direct contact with taxpayers known to have participated in a tax shelter promotion.

(B) *Taxpayer acting in good faith—*(*1*) *In general*. The IRS may suspend interest relating to a listed transaction or an undisclosed reportable transaction accruing on or before October 3, 2004, if the taxpayer has acted reasonably and in good faith. The IRS' determination of whether a taxpayer has acted reasonably and in good faith will take into account all the facts and circumstances surrounding the transaction. The facts and circumstances include, but are not limited to, whether the taxpayer disclosed the transaction and the taxpayer's course of conduct after being identified as participating in the transaction, including the taxpayer's response to opportunities afforded to the taxpayer to settle the transaction, and whether the taxpayer engaged in unreasonable delay at any stage of the matter.

(*2*) *Presumption*. If a taxpayer and the IRS promptly enter into a settlement agreement with respect to a transaction on terms proposed by the IRS or, in the event of atypical facts and circumstances, on terms more favorable to the taxpayer, and the taxpayer has complied with the terms of that agreement without unreasonable delay, the taxpayer will be presumed to have acted reasonably and in good faith except in rare and unusual circumstances. Rare and unusual circumstances must involve specific actions involving harm to tax administration. Even if a taxpayer does not qualify for the presumption described in this paragraph (b)(5)(iii)(B)(*2*), the taxpayer may still be granted interest suspension under the general facts and circumstances test set forth in paragraph (b)(5)(iii)(B)(*1*) of this section.

(*3*) *Examples*. The following examples illustrate the rules the IRS uses in determining whether a taxpayer has acted reasonably and in good faith.

Example 1. The taxpayer participated in a listed transaction. The IRS, in a letter sent directly to the taxpayer in July 2005, proposed a settlement of the transaction. The taxpayer informed the IRS of his interest in the settlement within the prescribed time period. The revenue agent assigned to the taxpayer's case was not able to calculate the taxpayer's liability under the settlement or tender a closing agreement to the taxpayer until March 2006. The taxpayer promptly executed the closing agreement and returned it to the IRS with a proposal for arrangements to pay the agreed-upon liability. The IRS agreed with the proposed arrangements for full payment. For purposes of the application of section 6404(g)(2)(E), the taxpayer has acted reasonably and in good faith. Interest accruing on or before October 3, 2004, relating to the transaction in which the taxpayer participated will be suspended.

Example 2. The facts are the same as in *Example 1*, except that the letter was sent by the IRS in February 2006, and the closing agreement was tendered to the taxpayer in April 2006. For purposes of the application of section 6404(g)(2)(E), the taxpayer has acted reasonably and in good faith. Interest accruing on or before October 3, 2004, relating to the transaction in which the taxpayer participated will be suspended.

Example 3. The taxpayer participated in a listed transaction. In response to an offer of settlement extended by the IRS in August 2005, the taxpayer informed the IRS of her interest in entering into a closing agreement on the terms proposed by the IRS. The revenue agent assigned to the transaction calculated the taxpayer's liability under the settlement and tendered a closing agreement to the taxpayer in November 2005. The taxpayer executed the closing agreement but failed to make any arrangement for payment of the agreed-upon liability stated in the closing agreement. Taking into account all the facts and circumstances surrounding the transaction, the taxpayer did not act reasonably and in good faith. Interest accruing on or before October 3, 2004, relating to the transaction in which the taxpayer participated will not be suspended.

Example 4. The taxpayer participated in a listed transaction. In a letter sent by the IRS directly to the taxpayer in July 2005, the IRS extended an offer of settlement. The July 2005 letter informed the taxpayer that, absent atypical facts and circumstances, the taxpayer should not expect resolution of the tax issues on more favorable terms than proposed in the letter. The taxpayer declined the proposed settlement terms of the letter and proceeded to Appeals to present what the taxpayer claimed were atypical facts and circumstances. The administrative file did not contain sufficient information bearing on atypical facts and circumstances, and the taxpayer failed to provide additional information when requested by Appeals to explain how the transaction originally proposed to the taxpayer differed in structure or types of tax benefits claimed, from the transaction as implemented by the taxpayer. Appeals determined that the taxpayer's facts and circumstances were not significantly different from those of other taxpayers who participated in that listed transaction and thus, were not atypical. In September 2006, the taxpayer and Appeals entered into a closing agreement on terms consistent with those originally proposed in the July 2005 letter. The taxpayer has complied with the terms of that closing agreement. For purposes of the application of section 6404(g)(2)(E), this taxpayer is not presumed to have acted reasonably and in good faith; instead, the IRS will apply the general rule to determine whether to suspend interest accruing on or before October 3, 2004, relating to the transaction in which the taxpayer participated.

Example 5. The facts are the same as in *Example 4*, except that Appeals agrees that atypical facts were present that warrant additional concessions by the government. A settlement is reached on terms more favorable to the taxpayer than those proposed in the July 2005 letter. For purposes of the application of section 6404(g)(2)(E), this taxpayer is presumed to have acted reasonably and in good faith, and absent evidence of rare or unusual circumstances harmful to tax administration, is eligible for suspension of interest accruing on or before October 3, 2004, relating to the transaction in which the taxpayer participated.

(C) *Closed transactions*. A transaction is considered closed for purposes of this clause if, as of December 14, 2005, the assessment of all federal income taxes for the taxable year in which the tax liability to which the interest relates is prevented by the operation of any law or rule of law, or a closing agreement under section 7121 has been entered into with respect to the tax liability arising in connection with the transaction.

(c) [Reserved].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 15, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 20, 2007, 8:53 a.m., and published in the issue of the Federal Register for June 21, 2007, 72 F.R. 34176)

Part III. Administrative, Procedural, and Miscellaneous

Repayment of Commodity Credit Corporation Loans

Notice 2007–63

PURPOSE

This notice provides answers to frequently asked questions regarding the tax treatment of "market gain" associated with the repayment of Commodity Credit Corporation (CCC) loans under the nonrecourse marketing assistance loan program authorized under the Farm Security and Rural Investment Act of 2002, Pub. L. No. 107–171, 116 Stat. 134 (2002). Under §§ 1201–1204 of that Act, 7 U.S.C. §§ 7931–7934, as amended by § 763(b)–(c) of Division A of the Consolidated Appropriations Resolution, 2003, Pub. L. No. 108–7 (2003), the CCC provides nonrecourse marketing assistance loans for the 2002–2007 crops of certain commodities (the 2002 Act nonrecourse marketing assistance loan program). This notice provides answers for taxpayers that elect, and those that do not elect, to include the proceeds of CCC loans in income under § 77 of the Internal Revenue Code.

BACKGROUND

Under § 77, a taxpayer receiving amounts as loans from the CCC may elect to include those amounts in gross income for the taxable year in which received. Most individual taxpayers report the loan proceeds as a Commodity Credit Corporation loan on line 7a of Schedule F, *Profit or Loss From Farming*. A taxpayer that makes the election under § 77 for any taxable year must compute income using that method for all subsequent years until the taxpayer receives the permission of the Internal Revenue Service to change to a different method of accounting. Rev. Proc. 2002–9, 2002–1 C.B. 327, provides procedures under which a taxpayer may obtain automatic consent of the Service to change the taxpayer's method of accounting for CCC loans from including the loan amount in gross income to treating the loan amount as a loan.

Under the 2002 Act nonrecourse marketing assistance loan program, CCC loans for each eligible commodity are made at a specified rate per unit of commodity (the original loan rate). The repayment amount for a loan secured by the pledge of an eligible commodity generally is based on the lower of the original loan rate or the alternative repayment rate, as determined by the CCC, for the commodity as of the date of repayment. The alternative repayment rate may be adjusted to reflect quality and location for each type of commodity. A taxpayer can use cash to repay a CCC loan, purchase CCC certificates for use in repayment of the loan, or deliver the pledged collateral as full payment for the loan at maturity. CCC certificates are available for purchase by producers that have outstanding commodity loans for which a crop is pledged as collateral.

If a taxpayer uses cash or CCC certificates to repay a CCC loan, and the loan is repaid when the alternative repayment rate is less than the original loan rate, the difference between the original loan amount and the lesser repayment amount is market gain. Regardless of whether a taxpayer repays a CCC loan in cash or uses CCC certificates in repayment of the loan, the market gain is taken into account either as income (if the taxpayer has not made an election under § 77) or as an adjustment to the basis of the commodity (if the taxpayer has made an election under § 77).

QUESTIONS AND ANSWERS

The answers to the following questions apply whether a taxpayer repays a CCC loan with cash or uses CCC certificates in repayment of the loan.

Q–1. How does a taxpayer that has elected under § 77 to include the amount of CCC loans in gross income report market gain associated with the repayment of a CCC loan?

A–1. A taxpayer that has made an election under § 77 accounts for market gain for the year in which a CCC loan is repaid by making an adjustment to the basis of the commodity that secures the loan. The taxpayer's basis in the commodity before the repayment of the loan is equal to the amount of the loan previously reported as income. That basis is reduced by the amount of any market gain associated with the repayment of the loan. An individual taxpayer that has made a § 77 election should report the market gain as an Agricultural Program Payment on line 6a of Schedule F, but not as a taxable amount on line 6b, for the year in which the loan is repaid.

Q–2. How does a taxpayer that has not elected under § 77 to include the amount of CCC loans in gross income report market gain associated with the repayment of a CCC loan?

A–2. A taxpayer that has not made an election under § 77 reports market gain as income for the year in which a CCC loan is repaid. An individual taxpayer that has not made an election under § 77 should report the market gain as an Agricultural Program Payment on line 6a and as a taxable amount on line 6b of Schedule F for the year in which the loan is repaid.

Q–3. Will the market gain associated with the repayment of a CCC loan be reported to a taxpayer whether the taxpayer repays a CCC loan with cash or uses CCC certificates in repayment of the loan?

A–3. Yes. For loans repaid on or after January 1, 2007, the CCC reports market gain associated with the repayment of a CCC loan whether the taxpayer repays the loan with cash or uses CCC certificates in repayment of the loan. The CCC reports the market gain on Form 1099–G, *Certain Government Payments*.

DRAFTING INFORMATION

The principal author of this notice is Marnette M. Myers of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice (except Q&A–3), contact Ms. Myers at (202) 662–4920. For further information regarding Q&A–3 of this notice, contact Stephen J. Coleman of the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622–4910 (not toll-free calls).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, § 42; 1.42–14.)

Rev. Proc. 2007–55

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 2007.

SECTION 2. BACKGROUND

Rev. Proc. 92–31, 1992–1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 2007.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2007 is as follows:

Qualified State	*Amount Allocated*
Alabama	$ 107,371
Alaska	15,643
Arizona	143,961
California	851,151
Connecticut	81,825
Delaware	19,926
Florida	422,333
Georgia	218,614
Illinois	299,580
Indiana	147,398
Kansas	64,531
Kentucky	98,197
Maine	30,854
Maryland	131,107
Massachusetts	150,285
Michigan	235,697
Minnesota	120,633
Missouri	136,406
Nebraska	41,284
New Hampshire	30,698
New Jersey	203,687
New Mexico	45,633
New York	450,729
North Carolina	206,767
North Dakota	14,845
Ohio	267,970
Oklahoma	83,562
Oregon	86,399
Pennsylvania	290,443
Rhode Island	24,925
South Carolina	100,885
South Dakota	18,255
Tennessee	140,984
Texas	548,821
Utah	59,535
Vermont	14,566
Virginia	178,434
Washington	149,319
Wisconsin	129,724
Wyoming	12,023

EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 2007.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of

the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson at (202) 622–3040 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 42 Utility Allowance Regulations Update

REG–128274–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that amend the utility allowances regulations concerning the low-income housing tax credit. The proposed regulations update the utility allowances regulations to provide new options for estimating tenant utility costs. The proposed regulations affect owners of low-income housing projects who claim the credit, the tenants in those low-income housing projects, and the state and local housing credit agencies who administer the credit. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 17, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 9, 2007, must be received by September 18, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–128274–03), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–128274–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–128274–03). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Selig, at (202) 622–3040; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard Hurst, at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking in §1.42–10(b)(4)(ii) have previously been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1102.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to the low-income housing credit under section 42 of the Internal Revenue Code. Section 42(a) provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building. A qualified low-income building is defined in section 42(c)(2) as any building that is part of a qualified low-income housing project.

A qualified low-income housing project is defined in section 42(g)(1) as any project for residential rental housing if the project meets one of the following tests elected by the taxpayer: (1) At least 20 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (2) at least 40 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income. If a taxpayer does not meet the elected test, the project is not eligible for the section 42 credit.

In order to qualify as a rent-restricted unit within the meaning of section 42(g), the gross rent for the unit must not exceed 30 percent of the applicable income limitation. If any utilities are paid directly by the tenant, section 42(g)(2)(B)(ii) requires the inclusion in gross rent of a utility allowance determined by the Secretary, after taking into account the procedures under section 8 of the United States Housing Act of 1937.

Section 1.42–10(b) provides rules for calculating the appropriate utility allowance based upon whether (1) the building receives rental assistance from the Farmers Home Administration (FmHA), now known as the Rural Housing Service; (2) the building has any tenant that receives FmHA rental assistance; (3) the building's rents and utility allowances are reviewed by the Department of Housing and Urban Renewal (HUD) on an annual basis; or (4) the building is not described in (1), (2), or (3) above (other buildings).

Under §1.42–10(b)(4), other buildings generally use the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program or use a local utility company estimate. The local utility company estimate may be obtained by any interested party (including a low-income tenant, a building owner, or a State or local housing credit agency (Agency)).

Explanation of Provisions

The IRS and Treasury Department have received comments from organizations representing tenants, non-profit housing organizations, housing credit agencies, building owners, building management companies, developers, and others noting that the existing methods in §1.42–10 that provide rules for calculating utility expenses often result in flawed information being used for calculating rent adjustments and need updating. These organizations assert that PHA utility schedules referenced by the existing regulations do not represent the proper usage of utilities for low-income housing tax credit units. This is primarily because PHA utility schedules are designed for Section 8 properties, which generally are older buildings with higher utility costs, whereas low-income

housing projects require measurements that are appropriate for new construction. Further, a number of project developers, owners, and building managers have indicated that they are unable to obtain local utility estimates due to a lack of data or an unwillingness on the part of utility companies to provide the information. Even if a utility company is willing to provide an initial estimate, annual updates are often difficult to obtain. Therefore, these commentators have recommended that §1.42–10 be amended to provide more viable and accurate options for estimating tenant utility costs.

In response to these concerns, §1.42–10(b)(4)(ii) is amended by these proposed regulations to provide additional options for accurately calculating utility allowances. Section 1.42–10(b)(4)(ii)(B), which permits any interested party to obtain a local utility company estimate for a unit, is revised to accommodate multiple utility services to a property. When charges for electricity transmission and distribution are paid to more than one company, cost estimates must be obtained from each of the utilities when computing the utility allowance.

Section 1.42–10(b)(4)(ii) is amended to permit a building owner to obtain a utility estimate for each unit in a building from the Agency that has jurisdiction over the building. The Agency's estimate must take into account the local utility rate data, property type, climate variables by region in the State, taxes and fees on utility charges, and property building materials and mechanical systems. An Agency may also use actual utility company usage data and rates for the building.

Further, the regulations are proposed to be amended to permit a building owner to calculate utility allowances using the "HUD Utility Schedule Model" that can be found on the Low-Income Housing Tax Credits page at *www.huduser.org/datasets/lihtc.html*. The HUD Utility Schedule Model is based on data from the Residential Energy Consumption Survey (RECS) conducted by the Department of Energy. RECS data provides energy consumption by structure for heating, air conditioning, cooking, water heating, and other electric (lighting and refrigeration). The HUD Utility Schedule Model incorporates building location and climate. A building owner who chooses to use the HUD Utility Schedule Model must furnish a copy of the calculations using the HUD Utility Schedule Model to the Agency that has jurisdiction over the building. A building owner also must make available copies of the calculations to the tenants in the building.

Section 1.42–10(c) provides that if the applicable utility allowance for a unit in a building changes, the new utility allowance must be used to compute gross rent of rent-restricted units due 90 days after the change. Commentators requested that this rule be modified to restrict changes to the building's utility allowance until after the building has achieved 90 percent occupancy for a period of 90 consecutive days, or by the end of the first year of the credit period, whichever is earlier. The proposed regulations adopt this comment. Section 1.42–10(c) also is modified to require that a building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance. The review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

The IRS and Treasury Department request comments on whether other methods should be used for calculating utility allowances such as energy or water and sewer services using a software model run by a State-certified engineer who is approved by the Agency that has jurisdiction over the building.

Proposed Effective Date

The regulations are proposed to apply to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 9, 2007, at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 30 minutes before the hearing starts. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments by September 17, 2007 and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 18, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.42–10 is amended by:

1. Revising the first sentence of paragraph (a).

2. Revising paragraphs (b)(1), (b)(2), (b)(3), (b)(4) introductory text and (c).

3. Removing the language "HUD rental assistance" from the first place that it appears in paragraph (b)(4)(i) and adding the language "rental assistance from the Department of Housing and Urban Development" in its place.

4. Adding two sentences at the end of paragraph (b)(4)(ii)(A).

5. Revising the second sentence in paragraph (b)(4)(ii)(B).

6. Adding new paragraphs (b)(4)(ii)(C) and (b)(4)(ii)(D).

The additions and revisions read as follows:

§1.42–10 Utility allowances.

(a) * * * If the cost of any utility (other than telephone or cable television) for a residential rental unit is paid directly by the tenant(s), the gross rent for that unit includes the applicable utility allowance determined under this section. * * *

(b) *Applicable utility allowances*—(1) *Buildings assisted by the Rural Housing Service.* If a building receives assistance from the Rural Housing Service (RHS-assisted building) the applicable utility allowance for all rent-restricted units in the building is the utility allowance determined under the method prescribed by the Rural Housing Service (RHS) for the building.

(2) *Buildings with Rural Housing Service assisted tenants.* If any tenant in a building receives RHS rental assistance payments (RHS tenant assistance), the applicable utility allowance for all rent-restricted units in the building (including any units occupied by tenants receiving rental assistance payments from the Department of Housing and Urban Development (HUD)) is the applicable RHS utility allowance.

(3) *Buildings regulated by the Department of Housing and Urban Development.* If neither a building nor any tenant in the building receives RHS housing assistance, and the rents and utility allowances of the building are reviewed by HUD on an annual basis (HUD-regulated building), the applicable utility allowance for all rent-restricted units in the building is the applicable HUD utility allowance.

(4) *Other buildings.* If a building is neither an RHS-assisted nor a HUD-regulated building, and no tenant in the building receives RHS tenant assistance, the applicable utility allowance for rent-restricted units in the building is determined under the following methods.

(i) * * *

(ii) * * * (A) * * * However, if a local utility company estimate is obtained for any unit in the building under paragraph (b)(4)(ii)(B) of this section, a State or local housing credit agency (Agency) provides a building owner with an estimate for any unit in a building under paragraph (b)(4)(ii)(C) of this section, or a cost estimate is calculated using the HUD Utility Schedule Model under paragraph (b)(4)(ii)(D) of this section, then the estimate under paragraph (b)(4)(ii)(B), (C), or (D) of this section becomes the applicable utility allowance for all rent-restricted units of similar size and construction in the building. Paragraphs (b)(4)(ii)(B), (C), and (D) of this section do not apply to units to which the rules of paragraphs (b)(1), (2), (3), or (4)(i) of this section apply.

(B) * * * The estimate is obtained when the interested party receives, in writing, information from a local utility company (including combined rate charges from multiple utility companies) providing the estimated cost of the utilities provided by that company for a unit of similar size and construction for the geographic area in which the building containing the unit is located.

(C) *Agency estimate.* A building owner may obtain a utility estimate for each unit in the building from the Agency that has jurisdiction over the building provided the Agency agrees to provide the estimate. The estimate is obtained when the building owner receives, in writing, information from the Agency providing the estimated per-unit cost of the utilities for units of similar size and construction for the geographic area in which the building containing the units is located. The Agency estimate may be obtained by a building owner at any time during the building's extended use period (see section 42(h)(6)(D)). Costs incurred in obtaining the estimate are borne by the building owner. In establishing an accurate utility allowance estimate for a particular building, an Agency (or an agent or other private contractor of the Agency) must take into account, among other things, local utility rate data, property type, climate and degree-day variables by region in the state, taxes and fees on utility charges, building materials, and mechanical systems. An Agency may also use actual utility company usage data and rates for the building.

(D) *HUD Utility Schedule Model.* A building owner may calculate a utility estimate using the "HUD Utility Schedule Model" that can be found on the Low-Income Housing Tax Credits page at *www.huduser.org/datasets/lihtc.html.* A building owner who chooses this method must furnish a copy of the calculations using the HUD Utility Schedule Model to the Agency that has jurisdiction over the building. A building owner also must make available copies of the calculations to the tenants in the building.

(c) *Changes in applicable utility allowance*—(1) *In general.* If at any time during the building's extended use period, the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of rent-restricted units due 90 days after the change. For example, if rent must be lowered because a local utility company estimate is obtained that shows a higher utility cost than the otherwise applicable PHA utility allowance, the lower rent must be in effect for rent due more than 90 days after the date of the local utility company estimate.

This paragraph (c)(1) does not apply until the building has achieved 90 percent occupancy for a period of 90 consecutive days or by the end of the first year of the credit period, whichever is earlier.

(2) *Annual review.* A building owner must review at least annually the basis on which utility allowances have been established and must update the applicable utility allowance in accordance with paragraph (c)(1) of this section. The review must take into account any changes to the building such as any energy conservation measures that affect energy consumption and changes in utility rates.

Par. 3. Section 1.42–12 is amended by adding paragraph (a)(4) to read as follows:

§1.42–12 Effective/applicability dates and transitional rules.

(a) * * *

(4) *Utility allowances.* Section 1.42–10 is applicable to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 18, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 19, 2007, 72 F.R. 33703)

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 42 Qualified Contract Provisions

REG–114084–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: Section 42(h)(6)(F) requires the Secretary to prescribe such regulations as may be necessary or appropriate to carry out the provisions of section 42(h)(6)(F), including regulations to prevent the manipulation of the qualified contract amount. This document contains proposed regulations that provide guidance concerning taxpayers' requests to housing credit agencies to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The regulations will affect taxpayers requesting a qualified contract, potential buyers, and low-income housing credit agencies responsible for the administration of the low-income housing credit program. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 17, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 15, 2007, must be received by September 13, 2007.

ADDRESSES: Send submissions to: Internal Revenue Service, CC:PA:LPD:PR (REG–114084–04), room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–114084–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or may be sent electronically via the Federal eRulemaking Portal at: *www.regulations.gov* (IRS REG–114084–04). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jack Malgeri (202) 622–3040; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by August 20, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.42–18(a)(1)(ii)(B). This information is required in order for a taxpayer to provide a written request to a housing credit agency to obtain a qualified contract (as defined in section 42(h)(6)(F) of the Internal Revenue Code) for the acquisition of a low-income housing credit building. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 20,000 hours.

Estimated average annual burden hours per respondent: 1 hour.

Estimated number of respondents: 20,000.

Estimated annual frequency of responses: one time.

An agency may not conduct or sponsor, and a person is not required to respond to, a

collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 under section 42 of the Internal Revenue Code (Code). Section 42 was amended by section 7108(c)(1) of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101–239, 103 Stat. 2106) to add paragraph (h)(6). In general, section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of the taxable year.

Section 42(h)(6)(B) provides in part that the term commitment means any agreement between the taxpayer and the low-income housing credit agency (Agency) that requires that the applicable fraction (as defined in section 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the commitment, and that prohibits the eviction or termination of tenancy (other than for good cause) of an existing tenant of any low-income unit and any increase in the gross rent with respect to the unit not otherwise permitted under section 42.

Section 42(h)(6)(D) defines the term extended use period as the period beginning on the first day in the compliance period under section 42(i)(1) on which the building is part of a qualified low-income housing project and ending on the later of: (1) the date specified by the Agency in the commitment, or (2) the date which is 15 years after the close of the compliance period.

Section 42(h)(6)(E)(i)(II) provides for the termination of the extended use period if the Agency is unable to present within a specified period of time a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a low-income building.

Section 42(h)(6)(F) defines the term qualified contract as a *bona fide* contract to acquire (within a reasonable period of time after the contract is entered into) the non low-income portion of the building for fair market value and the low-income portion of the building for an amount not less than the applicable fraction (specified in the commitment) of the sum of: (I) the outstanding indebtedness secured by, or with respect to the building, (II) the adjusted investor equity in the building, plus (III) other capital contributions not reflected in these amounts, reduced by cash distributions from (or available for distribution from) the project.

Section 42(h)(6)(F) also provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out that paragraph, including regulations to prevent the manipulation of the amount determined under section 42(h)(6)(F).

Section 42(h)(6)(I) provides that the Agency must present the qualified contract within the 1-year period beginning on the date (after the 14^{th} year of the compliance period) the taxpayer submits a written request to the Agency to find a person to acquire the taxpayer's interest in the low-income portion of the building.

These proposed regulations provide guidance with respect to the application of the qualified contract provisions of section 42.

Explanation of Provisions

Qualified Contract Formula

Section 1.42–18(c)(1) of the proposed regulations defines the qualified contract formula used to compute the purchase price amount of the low-income housing building as: (1) the fair market value of the non low-income portion of the building, plus (2) the low-income portion of the building. Section 1.42–18(c)(2) of the proposed regulations defines the low-income portion of the building as an amount not less than the applicable fraction (as specified in the commitment) of the total of: (a) outstanding indebtedness on the building, plus (b) the adjusted investor equity in the building, plus (c) other capital contributions not reflected in the amounts described in (a) and (b), minus (d) cash distributions from (or available for distribution from) the project.

Under §1.42–18(b)(3) of the proposed regulations, the fair market value of the non low-income portion of the building is its fair market value at the time of the Agency's offer of sale. Because the intent of the extended-long term commitment is the continued use of the low-income portion of the building as low-income housing, the Treasury Department and IRS believe that fair market value must reflect the restrictions on the use of the low-income portion of the building. Therefore, the proposed regulations provide that the valuation must take into account the existing and continuing requirements under the commitment for the building.

Section 42(h)(6) does not discuss the appropriate treatment of land in the calculation of qualified contracts. Qualified contracts are defined by reference to the building, which for other purposes of section 42 generally does not include the underlying land. However, because the Treasury Department and the IRS anticipate that the sales of the building without the underlying land would be infrequent, the Treasury Department and the IRS believe that it is necessary to include the underlying land in the computation of the qualified contract formula. Therefore, the proposed regulations provide that the non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion, regardless of whether the building is entirely low-income. Comments are requested on whether low-income buildings are ever sold without the underlying land, and if so, the appropriate treatment in those cases. In addition, comments are requested on the appropriate treatment of leased land and the prevalence of leased land in low-income housing credit transactions.

For purposes of determining the low-income portion of the building, §1.42–18(c)(3) defines the term outstanding indebtedness as the outstanding principal balance, at the time of the sale, of any indebtedness or loan that is secured by, or with respect to, the building, and that does not exceed the amount of qualifying building costs. Qualifying building costs are generally defined in §1.42–18(b)(4) of the proposed regulations as those costs that would have been includible in eligible

basis of a low-income housing building under section 42(d)(1), provided the amounts were expended for depreciable property that conveys under the contract with the building. Thus, for example, the outstanding mortgage on the building will generally be outstanding indebtedness for purposes of section 42(h)(6)(F), even if the indebtedness is incurred after the first year of the credit period, but only up to the amount of costs included in original eligible basis established at the end of the first year of the credit period under section 42(f)(1), plus indebtedness for qualifying building costs incurred after the first year of the credit period of a type that could be includible in eligible basis under section 42(d)(1). Thus, any proceeds from refinancing indebtedness or additional mortgages in excess of such qualifying building costs are not outstanding indebtedness for purposes of section 42(h)(6)(F).

Outstanding indebtedness with an interest rate below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance must be discounted using a present-value calculation to obtain an imputed principal amount. This imputed principal amount constitutes the amount of indebtedness that must be utilized in calculating the amount of outstanding indebtedness under the qualified contract formula.

Section 1.42–18(c)(4) of the proposed regulations provides that adjusted investor equity includes only those cash investments by owners of the low-income building used for qualifying building costs. Investor equity is adjusted by a cost of living adjustment not to exceed five percent. The cost-of-living adjustment is determined under section 1(f)(3), substituting the language in section 1(f)(3)(B) with "the CPI for the base calendar year." The base calendar year is the calendar year with or within which the first taxable year of the credit period ends. Thus, the cost-of-living adjustment is the percent by which the Consumer Price Index (CPI) for the year preceding the written request to find a person to acquire the project exceeds the CPI for the base calendar year.

Under §1.42–18(c)(5) of the proposed regulations, other capital contributions are defined as contributions for qualifying building costs other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. An example of other capital contributions includes an amount expended to replace a furnace after the first year of the credit period, provided any loan taken to finance the furnace was not secured by the furnace or the building. In this example, the loan would be outstanding indebtedness on the building.

Qualifying building costs are defined under §1.42–18(b)(4)(i) and (ii) of the proposed regulations. Under §1.42–18(b)(4)(i) of the proposed regulations, a qualifying building is a cost included in eligible basis under section 42(d)(1). A cost is included in eligible basis under section 42(d)(1) only if the cost is (1) included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and §1.103–8(b)(4)(iii), or (2) included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building, but only if the property conveys under the contract with the building. A qualifying building cost also includes costs incurred after the first year of the credit period (as defined in section 42(f)) of the type included in eligible basis under section 42(d)(1). See §1.42–18(b)(4)(ii) of the proposed regulations.

Under the qualified contract formula, the sum of the outstanding indebtedness, adjusted investor equity, and other capital contributions is reduced by cash distributions from or available for distribution from the project. Section 1.42–18(c)(6) of the proposed regulations defines cash distributions as including all distributions to owners or related parties within the meaning of section 267(b) or 707(b) (for example, cash distributions to owners from the proceeds of refinancings and second mortgages in excess of existing mortgages), and all cash and cash equivalents including reserve funds (for example, replacement and operating reserves) generated by cash flow from the project. To the extent an owner contributed his or her own funds to a reserve fund for replacement and improvements, such amounts are evaluated as either adjusted investor equity or other capital contributions. The Treasury Department and the IRS request comments and examples of forms of cash distributions from or available for distribution from the project that should or should not be included in the regulatory definition. Additionally, comments are requested whether low-income housing is owned by other than a corporation or partnership, for example, a sole proprietor, estate, or trust, and if so, what rules should apply for determining the amount of cash distributions from the project.

Administrative Discretion and Responsibilities of Agency

Under §1.42–18(d)(1) of the proposed regulations, the Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. For example, the Agency may determine that an owner's request to find a buyer for the project lacks essential information and it may suspend the one-year period for finding a buyer until essential information is submitted.

Actual Offer of Sale

Section 1.42–18(d)(2) of the proposed regulations provides that in order to satisfy the qualified contract requirements under section 42(h)(6), the Agency must offer the building for sale to the general public at the determined qualified contract price upon receipt of a written request by the owner to find a buyer to acquire the building.

Fair Market Value Cap

Commentators suggested the inclusion of a fair market value cap on the low-income portion of the qualified contract amount as defined in section 42(h)(6)(F) noting that the qualified contract price may exceed the fair market value of a project. Commentators noted one reason for the qualified contract price exceeding fair market value is the formula for adjusted investor equity, which includes the CPI-based cost of living adjustments. The statute defines a qualified contract, in part, as a contract to acquire the low-income portion of the building for an amount "not less than" the applicable fraction of the statutorily provided formula. Therefore, the proposed regulations do not adopt this comment. However, the flush language of section 42(h)(6)(E) provides that the qualified contract exception to the termination

of the extended use period of a commitment shall not apply to the extent more stringent requirements are provided in the commitment or in state law. The Treasury Department and the IRS request comments on the extent of Agency and state authority in providing more stringent requirements than the provisions contained in section 42(h)(6)(F), and specifically, the authority of Agency or state regulators to require in agreements a fair market value cap that would restrict any qualified contract price to fair market value.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information described under the heading "Paperwork Reduction Act" imposes virtually no incremental burden in time or expense and is voluntary for the taxpayer to obtain a benefit. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 15, 2007, beginning at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments on September 17, 2007 and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 13, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Jack Malgeri, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.42–18 also issued under 26 U.S.C. 42(h)(6)(F) and 42(h)(6)(K); * * *

Par. 2. Section 1.42–18 is added to read as follows:

§1.42–18 Qualified contracts.

(a) *Extended low-income housing commitment*—(1) *In general.* No credit under section 42(a) is allowed by reason of section 42 and this section with respect to any building for the taxable year unless an extended low-income housing commitment (commitment) (as defined in section 42(h)(6)(B)) is in effect as of the end of such taxable year. A commitment must be in effect for the extended use period (as defined in paragraph (a)(1)(i) of this section).

(i) *Extended use period.* The term *extended use period* means the period beginning on the first day in the compliance period (as defined in section 42(i)(1)) on which the building is part of a qualified low-income housing project (as defined in section 42(g)(1)) and ending on the later of—

(A) The date specified by the low-income housing credit agency (Agency) in the commitment; or

(B) The date that is 15 years after the close of the compliance period.

(ii) *Termination of extended use period.* The extended use period under paragraph (a)(1)(i) of this section for any building will terminate—

(A) On the date the building is acquired by foreclosure (or instrument in lieu of foreclosure) unless the Secretary determines that such acquisition is part of an arrangement with the taxpayer a purpose of which is to terminate such period; or

(B) On the last day of the one-year period beginning on the date (after the 14th year of the compliance period) the owner submits a written request to the Agency to find a person to acquire the owner's interest in the low-income portion of the building and the Agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will continue to operate such portion as a qualified low-income building (as defined in section 42(c)(2)). This paragraph (a)(1)(ii)(B) shall not apply to the extent more stringent requirements are provided in the commitment or under state law. If the Agency provides a qualified contract within the one-year period and the owner rejects or fails to act upon the contract, the building remains subject to the existing commitment.

(iii) *Eviction, gross-rent increase concerning existing low-income tenants not permitted.* During the three year period following the termination of a commitment, no owner shall be permitted to evict or terminate the tenancy (other than for good cause) of an existing tenant of any low-income unit, or increase the gross rent for such unit in a manner or amount not otherwise permitted by section 42.

(2) [Reserved].

(b) *Special rules.* For purposes of this section, the following terms are defined:

(1) *Base calendar year* means the calendar year with or within which the first taxable year of the credit period ends.

(2) *The low-income portion* of a building is the portion of the building equal to the applicable fraction (as defined in section 42(c)(1)) specified in the commitment for the building.

(3) *The fair market value* of the non low-income portion of the building is determined at the time of the Agency's offer of sale of the project to the general public. This valuation must take into account the existing and continuing requirements contained in the commitment for the building. The non low-income portion also includes the fair market value of the land underlying the entire building, both the non low-income portion and the low-income portion regardless of whether the project is entirely low-income. The non low-income portion also includes the fair market value of items of personal property not included in eligible basis under section 42(d)(1) that convey under the contract with the building.

(4) *A qualifying building cost* is—

(i) A cost that is included in eligible basis of a low-income housing building under section 42(d)(1) which is—

(A) Included in the adjusted basis of depreciable property subject to section 168 and the property qualifies as residential rental property under section 142(d) and §1.103–8(b)(4)(iii); or

(B) Included in the adjusted basis of depreciable property subject to section 168 that is used in a common area or provided as a comparable amenity to all residential rental units in the building; and

(ii) Of the type described in paragraph (b)(4)(i) of this section incurred after the first year of the low-income building's credit period under section 42(f).

(c) *Qualified contract purchase price formula*—(1) *In general.* For purposes of this section, the term *qualified contract* means a *bona fide* contract to acquire (within a reasonable period after the contract is entered into) the non low-income portion of the building for fair market value (as defined in paragraph (b)(3) of this section) and the low-income portion of the building (as defined in paragraph (b)(2) of this section) for the low-income portion amount as calculated in paragraph (c)(2) of this section. The qualified contract amount is determined at the time of the Agency's offer of sale of the project to the general public. An Agency must, however, adjust the amount of the low-income portion of the qualified contract formula to reflect changes in the components of the qualified contract formula such as mortgage payments which reduce outstanding indebtedness between the time of the seller's request to the Agency to obtain a buyer and the project's actual sale closing date. In addition, the Agency may adjust the fair market value of the building if, after a reasonable period of time within the one-year offer of sale period, no buyer has made an offer or market values have adjusted downward.

(2) *Low-income portion amount.* The low-income portion amount is an amount not less than the applicable fraction specified in the commitment, as defined in section 42(h)(6)(B)(i), multiplied by the total of—

(i) The outstanding indebtedness for the building (as defined in paragraph (c)(3) of this section); plus

(ii) The adjusted investor equity in the building (as defined in paragraph (c)(4) of this section); plus

(iii) Other capital contributions (as defined in paragraph (c)(5) of this section), not including any amounts described in paragraphs (c)(2)(i) and (ii) of this section; minus

(iv) Cash distributions from (or available for distribution from) the building (as defined in paragraph (c)(6) of this section).

(3) *Outstanding indebtedness.* (i) For purposes of paragraph (c)(2)(i) of this section, except as provided in paragraph (c)(3)(ii) of this section, the term *outstanding indebtedness* for the building means the remaining stated principal balance, at the time of the Agency's offer of sale of the project to the general public, of any indebtedness secured by, or with respect to, the building that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. Examples of such indebtedness include certain mortgages and developer fee notes (excluding developer service costs not included in eligible basis). Outstanding indebtedness does not include debt used to finance nondepreciable land costs, syndication costs, legal and accounting costs, and operating deficit payments. The term outstanding indebtedness for the building only includes obligations that are indebtedness under general principles of Federal income tax law.

(ii) For purposes of paragraph (c)(2)(i) of this section, if the indebtedness had a yield to maturity below the applicable Federal rate (as determined under section 1274(d)) at the time of issuance, the term outstanding indebtedness for the building is the imputed principal amount of the indebtedness, secured by, or with respect to, the building, at the time of the Agency's offer of sale of the project to the general public, that does not exceed the amount of qualifying building costs described in paragraph (b)(4) of this section. The imputed principal amount of the indebtedness is the sum of the present values, as of the Agency's offer of sale of the project to the general public, of all the remaining payments of principal and interest payable on the indebtedness after the Agency's offer of sale of the project to the general public. The present value of each payment is determined by using a discount rate equal to the applicable Federal rate (as determined under section 1274(d)) at the time of issuance of the indebtedness. In the case of a variable rate debt instrument, rules similar to those in §1.1274–2(f) are used to determine the instrument's imputed principal amount.

(4) *Adjusted investor equity.* (i) For purposes of paragraph (c)(2)(ii) of this section, the term *adjusted investor equity* for any calendar year means the aggregate amount of cash invested by owners for qualifying building costs described in paragraph (b)(4)(i) of this section. Thus, equity paid for land, credit adjuster payments, Agency low-income housing credit application and allocation fees, operating deficit contributions, and legal, syndication, and accounting costs all are examples of cost payments that do not qualify as adjusted investor equity under this section.

(ii) The adjusted investor equity as determined under paragraph (c)(4)(i) of this section is increased by an amount equal to the adjusted investor equity multiplied by the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting for the language in section 1(f)(3)(B), the Consumer Price Index for all urban consumers (CPI) (not seasonally adjusted, U.S. City Average) as specified in paragraph (c)(4)(v) of this section for the base calendar year (as defined in paragraph (b)(1) of this section).

(iii) Adjusted investor equity is taken into account under this section only to the extent there existed an obligation to invest the amount as of the beginning of the low-income building's credit period (as defined in section 42(f)(1)).

(iv) Adjusted investor equity does not include amounts included in the calculation of outstanding indebtedness as defined in paragraph (c)(3) of this section.

(v) *The cost-of-living adjustment* is based on the CPI as of the close of the 12-month period ending on August 31 of the calendar year. The *cost-of-living adjustment* is the percent by which the CPI for the year preceding the written request to find a person to acquire the taxpayer's project (CPI_p) exceeds the CPI for the base calendar year (CPI_b). If the CPI for any calendar year during this period (after the base calendar year) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under paragraph (c)(4) of this section. The adjusted investor equity equals the aggregate amount of cash invested by the taxpayer in the building multiplied by the ratio of CPI_p to CPI_b.

(vi) *Example.* The following example illustrates the CPI calculation:

Example. Owner contributed $600,000 in equity to a building in 1991, which was the first year of the credit period for the project. In year 2005, owner requests Agency to find a buyer to purchase the building. The CPI_b (at the close of the 12-month period ending on August 31, 1991) is 136.6. The CPI_p for the close of the 12-month period ending August 31, 2004, is 189.5. At no time during this period (after the base calendar year) did the CPI for any calendar year exceed the CPI for the preceding calendar year by more than 5 percent. The owner's adjusted investor equity is $600,000 multiplied by 189.5/136.6, or $832,357.

(5) *Other capital contributions.* For purposes of paragraph (c)(2)(iii) of this section, other capital contributions to a low-income building are qualifying building costs described in paragraph (b)(4)(ii) of this section paid or incurred by the owner of the low-income building other than amounts included in the calculation of outstanding indebtedness or adjusted investor equity as defined in this section. For example, other capital contributions may include amounts incurred to replace a furnace after the first year of a low-income housing credit building's credit period under section 42(f), provided any loan used to finance the replacement of the furnace is not secured by the furnace or the building. Other capital contributions do not include expenditures for land costs, operating deficit payments, credit adjuster payments, and payments for legal, syndication, and accounting costs.

(6) *Cash distribution*—(i) *In general.* For purposes of paragraph (c)(2)(iv) of this section, the term *cash distributions* from (or available for distribution from) the project include—

(A) All distributions from the project to the owners or to related parties within the meaning of section 267(b) or section 707(b)), including distributions under section 301 (relating to distributions by a corporation), section 731 (relating to distributions by a partnership), or section 1368 (relating to distributions by a S corporation); and

(B) All cash and cash equivalents available for distribution at the time of sale, including for example, reserve funds whether operating or replacement reserves.

(ii) *Anti-abuse rule.* The Commissioner will interpret and apply the rules in this paragraph (c)(6) as necessary and appropriate to prevent manipulation of the qualified contract amount. For example, cash distributions include payments to owners or related parties within the meaning of section 267(b) or section 707(b) for any operating expenses in excess of amounts reasonable under the circumstances.

(d) *Administrative responsibilities of the Agency*—(1) *In general.* An Agency may exercise administrative discretion in evaluating and acting upon an owner's request to find a buyer to acquire the building. Examples of administrative discretion may include but are not limited to the following:

(i) Concluding that the owner's request lacks essential information and denying the request until such information is provided.

(ii) Refusing to consider an owner's representations without substantiating documentation verified with the Agency's records.

(iii) Suspending the one-year period for finding a buyer until the owner provides requested information.

(iv) Determining how many subsequent requests to find a buyer, if any, may be submitted if the owner has previously submitted a request for a qualified contract and then rejects or fails to act upon the qualified contract furnished by the Agency.

(v) Assessing and charging the seller certain administrative fees for the performance of services in obtaining a qualified contract (for example, real estate appraiser costs).

(vi) Requiring other conditions applicable to the qualified contract consistent with this section.

(2) *Actual offer.* Upon receipt of a written request from the owner to find a person to acquire the building, the Agency must offer the building for sale at the determined qualified contract amount to the general public in order for the qualified contract to satisfy the requirements of this section unless the Agency has already identified a willing buyer who submitted a contract to purchase the building.

(e) *Effective/Applicability date.* This section is applicable on the date the final regulations are published in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 18, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 19, 2007, 72 F.R. 33706)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Application of Section 6404(g) of the Internal Revenue Code Suspension Provisions

REG–149036–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9333) relating to the application of section 6404(g) of the Internal Revenue Code (Code) suspension provisions. The regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998, the American Jobs Creation Act of 2004, the Gulf Opportunity Zone Act of 2005, the Tax Relief and Health Care Act of 2006, and the Small Business and Work Opportunity Tax Act of 2007. The regulations provide guidance to individual taxpayers who have participated in listed transactions or undisclosed reportable transactions. The text of those regulations also serve as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 19, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 11, 2007, at 10 a.m. must be received by September 20, 2007.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–149036–04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149036–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov*. (IRS REG–149036–04). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stuart Spielman, (202) 622–7950; concerning submissions of comments, the hearing, and to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622–7180 (not toll-free numbers) or *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Regulations on Procedure and Administration (26 CFR part 301) relating to section 6404(g). The temporary regulations add rules relating to the suspension of interest, penalties, additions to tax, or additional amounts with respect to listed or other reportable transactions. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. A regulatory assessment is therefore not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for October 11, 2007, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by September 19, 2007, and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 20, 2007. A period of ten minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting information

The principal author of these regulations is Stuart Spielman of the Office of Associate Chief Counsel (Procedure and Administration).

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Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6404–0 is amended as follows:

1. The introductory text is revised.

2. Entries are added for §301.6404–4.

The additions read as follows:

§301.6404–0 Table of contents.

This section lists the paragraphs contained in §§301.6404–1 through 301.6404–4.

* * * * *

§301.6404–4 Listed transactions and undisclosed reportable transactions.

[Reserved]. The text of the entries or this section is the same as the text of the entries in §301.6404T published elsewhere in this issue of the Bulletin.

Par. 3. Section 301.6404–4 is added to read as follows:

§301.6404–4 Listed transactions and undisclosed reportable transactions.

(a) through (b)(4) [Reserved].

(b)(5) [The text of proposed §301.6404–4(b)(5) is the same as the text of §301.6404–4T(b)(5) published elsewhere in this issue of the Bulletin].

(c) and (d) [Reserved].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 20, 2007, 8:53 a.m., and published in the issue of the Federal Register for June 21, 2007, 72 F.R. 34204)

Notice of Proposed Rulemaking and Notice of Public Hearing

Information Reporting and Backup Withholding for Payment Card Transactions

REG–163195–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the information reporting requirements, information reporting penalties, and backup withholding requirements for payment card transactions. The proposed regulations in this document affect payors (and their authorized agents) and payees of certain reportable payments and provide guidance necessary to comply with the law. The proposed regulations are necessary to address implementation and notice furnishing issues that arose after publication of final regulations under section 3406(g) that were published in the **Federal Register** on July 13, 2004 in Treasury decision 9136, 2004–2 C.B. 112 [69 FR 41928]). This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 9, 2007. Outlines of topics to be discussed at the public hearing scheduled for November 7, 2007, must be received by October 9, 2007.

Applicability dates: See the proposed effective date's section of the supplementary information.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–163195–05), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–163195–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–163195–05).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael Hara (202) 622–4910; concerning submission of comments, Kelly Banks (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these proposed regulations has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1819. Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by September 11, 2007. Comments are specifically requested concerning the accuracy of the estimated burden associated with the collection of information and suggestions on how the burden may be minimized.

The collection of information is in §31.3406(g)–1(f)(3). This information is necessary to notify a cardholder/payor that a merchant/payee is not a qualified payee for purposes of the regulations, and for cardholders/payors and merchant/payees to consent to receive notices electronically. This information will alert a cardholder/payor that backup withholding under section 3406 may apply for future reportable payments. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 37,239,570 hours.

Estimated average annual burden per respondent: 1.19 hours.

Estimated number of respondents: 31,256,000.

Estimated frequency of responses: monthly.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Background

This document contains proposed amendments to 26 CFR part 31 relating to backup withholding under section 3406 of the Internal Revenue Code (Code) and proposed amendments to 26 CFR part 301 relating to waivers under Code section 6724 of information reporting penalties under Code sections 6721 and 6722.

Section 6041(a) of the Code requires persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in any one taxable year to file information returns with the IRS. Section 6041(d) requires the payor to furnish information statements to payees. Among other items, the payor must include the payee's name and taxpayer identification number (TIN) on the information return and the information statement. Section 6041A of the Code imposes similar requirements with respect to payments of remuneration for services and direct sales.

In general, section 6721(a)(1) imposes a $50 penalty for each failure to file an information return on or before the required filing date, for any failure to include all of the information required to be shown on the return, or for the inclusion of incorrect information. Section 6722(a)(1) imposes similar penalties with respect to the information statements required to be furnished to payees. Section 6724(a) provides that no penalty will be imposed under section 6721 or section 6722 if it is shown that the failure is due to reasonable cause and not to willful neglect.

Section 3406(a)(1) requires a payor to withhold on any reportable payment (as defined in section 3406(b)(1)) if (1) the payee fails to furnish the payee's TIN to the payor as required or (2) the Secretary notifies the payor that the TIN furnished by the payee is incorrect. Section 3406(a)(1) also requires withholding in certain other situations that are not addressed in these regulations. Section 3406(i) provides that the Secretary shall prescribe the regulations necessary or appropriate to carry out the purposes of section 3406.

A payment card transaction is a transaction in which a cardholder/payor uses a payment card to purchase goods or services and a merchant agrees to accept a payment card as a means of obtaining payment. A payment card is a card (or an account) that (1) is issued by a payment card organization or one of its members, affiliates, or licensees to a cardholder/payor and (2) represents, upon presentation to a merchant/payee, an agreement of the cardholder to pay the merchant through the payment card organization. A payment card organization is an entity that sets the standards and provides the mechanism, acting directly or indirectly through its members, affiliates, or licensees, for effectuating payment between a purchaser and a merchant in a payment card transaction.

Information reporting compliance is difficult in payment card transactions because an invoice may not be issued, and the employee representing the cardholder/payor in the transaction might not request and obtain the name/TIN combination of the merchant/payee at the time of the transaction. In addition, backup withholding may be difficult because a merchant receives payment from the payment card organization within a few days after the transaction, but the cardholder does not pay the payment card organization until after it receives a payment card monthly billing statement.

2004 Regulations

On July 13, 2004, final regulations relating to the information reporting requirements, information reporting penalties, and backup withholding requirements for payment card transactions effectuated through a Qualified Payment Card Agent (QPCA) were published in the **Federal Register** (T.D. 9136; 69 FR 41938). These regulations (the 2004 QPCA regulations) provide limited exceptions to the backup withholding requirements for payment card transactions. The principal exception in §31.3406(g)–1(f)(1)(i) of the regulations applies if the payment is made through a QPCA and the payee is a qualified payee.

Section 31.3406(g)–1(f)(2)(vi) of the regulations provides that a payee is a qualified payee if, at the time of the payment, the QPCA has validated the payee's TIN through the IRS TIN Matching Program or if the payment is made during the six-month period following the date on which the QPCA first makes a payment to the payee (six-month grace period). Under the regulations, a QPCA must notify a cardholder/payor of any merchant/payees that are not qualified payees.

Section 31.3406(g)–1(f)(1)(ii) of the regulations provides a second exception for payments to persons other than qualified payees. Under this exception, reportable payments made through a QPCA are exempt from backup withholding if the purchase to which the payment relates is made no later than two months after the date by which the QPCA is required to provide notification to the payor that the payee is not a qualified payee.

In addition, the regulations provide in §301.6724–1(e) and (f) that cardholder/payors may establish, based on good faith reliance on a QPCA, that a failure subject to penalty under section 6721or 6722 is due to reasonable cause.

Other Guidance

On July 14, 2004, the IRS issued Rev. Proc. 2004–42, 2004–2 C.B. 121, which establishes procedures to implement the rules contained in the 2004 QPCA regulations. The revenue procedure provides that a QPCA may act on behalf of a cardholder/payor for purposes of soliciting, collecting, and validating the names/TINs of the merchant/payees and on behalf of a merchant/payee for purposes of furnishing the payee's name and TIN to the cardholder/payor. The revenue procedure also sets forth the requirements that a payment card organization must satisfy to obtain an IRS determination that it is a QPCA. These requirements include requirements that the payment card organization provide certain notifications to cardholder/payors and merchant/payees and obtain the authorization of cardholder/payors and merchant/payees to act on their behalf for certain purposes. See §601.601(d)(2)(ii)(*b*).

Requests for Changes

Some taxpayers subject to the 2004 QPCA regulations and related procedures

have requested that the regulations in §31.3406(g)–1(f) be amended, and the procedures in Rev. Proc. 2004–42 be modified, to allow a merchant to accept a QPCA's payment card even if the merchant opts out of the QPCA program. Taxpayers subject to the 2004 QPCA regulations and related procedures have also requested that the regulations be amended, and the procedures in Rev. Proc. 2004–42 be modified, to reflect the current electronic business operations of the payment card industry. Specifically, payment card organizations have asked that they be permitted to furnish required notifications electronically, including by posting on a secure website.

Explanation of Provisions

The IRS and the Treasury Department agree that a merchant/payee should be allowed to accept a QPCA's payment card even if the merchant/payee opts out of the QPCA program. The IRS is issuing a proposed revenue procedure providing that a merchant/payee may opt out of the QPCA program by completing and returning a written statement to the payment card organization and that a nonparticipating merchant/payee may continue to accept the organization's payment card. If a merchant/payee opts out of the QPCA program, payments to the merchant/payee made after the six-month grace period are treated under §31.3406(g)–1(f)(2)(vi) of the proposed regulations as payments to a person other than a qualified payee. In addition, the proposed regulations modify the rule permitting cardholders to rely on a QPCA to solicit, validate, and furnish a payee's TIN. Under proposed §301.6724–1(e)(1)(vi)(H), such reliance generally would not be permitted after the cardholder is notified that the merchant is not a participating payee.

These proposed regulations also modify the notification requirements in §31.3406(g)–1(f)(3) by adding notification requirements relating to payments to nonparticipating merchant/payees. Although QPCAs do not act on behalf of nonparticipating payees in furnishing payee data to cardholders, the proposed regulations provide that a QPCA is required to furnish certain information to cardholders that use the QPCA's card to make reportable payments to nonparticipating payees. Specifically, the QPCA would be required to inform the cardholder that the payee is not a participant in the QPCA program and is not a qualified payee. In addition, the QPCA must advise the cardholder/payor of the cardholder/payor's obligation to solicit the TIN of a nonparticipating merchant/payee to which it makes a reportable payment.

In the preamble to the 2004 QPCA regulations, the IRS and the Treasury Department indicated they were considering whether a QPCA should be allowed to furnish information regarding payee status electronically on a secure website. The IRS and the Treasury Department have concluded that it is appropriate to propose modifications to the QPCA regulations and related procedures to reflect the current electronic business operations of the payment card industry.

This is consistent with the precedent set in the electronic statement regulations issued under Code sections 6041, 6050S, and 6051 on February 18, 2004 (T.D. 9114, 2004–1 C.B. 589). In the electronic statement regulations, the IRS and Treasury Department allowed electronic furnishing of statements on Form W–2, "*Wage and Tax Statement*," Form 1098–T, "*Tuition Statement*," and Form 1098–E, "*Student Loan Interest Statement*," to individuals who consent to receive the statements electronically. The preamble to the electronic statement regulations explains that the regulations are consistent with the general goals of (1) section 2001 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206) to eliminate barriers, provide incentives, and use competitive forces to increase electronic filings and (2) the Electronic Signatures in Global and National Commerce Act (Public Law 106–229) to facilitate voluntary use of electronic records. The electronic statement regulations aimed at striking a balance between furnishers' desires to reduce costs and modernize business processes by furnishing statements electronically and the tax administration concern that individuals have secure access to the information they need to fulfill their Federal tax obligations.

The IRS and the Treasury Department have concluded that a similar balance is appropriate in this context and that payment card organizations should be allowed to furnish notifications of payee status and participation electronically, including by posting on a secure website, if certain requirements are met to assure consistency with the Electronic Signatures in Global and National Commerce Act. These proposed regulations provide that the notifications of payee status and participation may be furnished electronically if, among other things, the payment card organization (1) obtains certain consents from cardholder/payors and merchant/payees and (2) provides certain disclosures to cardholder/payors and merchant/payees.

Proposed Effective Date

Section 31.3406(g)–1(f)(3)(ii) (relating to electronic furnishing of notifications) is proposed to be effective on the date it is published as a final regulation, and the other amendments to §31.3406(g)–1 are proposed to be applicable to payments made after December 31, 2007. The amendments to §301.6724–1 are proposed to be applicable to information returns and information statements relating to payments made after December 31, 2007.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

When an Agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" which will "describe the impact of the proposed rule on small entities." (5 U.S.C. §603(a)). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities.

The proposed rule affects merchant/payees and card/holderpayors. The IRS estimates there are 5,200,000 merchant/payees and 26,054,000 cardholders/payors that qualify as small entities. Therefore, the IRS has determined that this proposed rule will have an impact on a substantial number of small entities.

The IRS has determined, however, that the impact on entities affected by the proposed rule will not be significant. The burden on a merchant/payee that opts out of the QPCA program by completing and returning a written statement to the payment card organization is minimal. The burden on cardholders/payees and merchant/payors that consent to electronic furnishing of notices by returning a consent form and confirming the consent electronically is also insignificant.

Although QPCAs have a reporting burden under the proposed rule to furnish certain notices to cardholder/payors, QPCAs are large businesses and do not fall under the definition of small entities.

Based on these facts, the IRS hereby certifies that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. The IRS invites comments from members of the public from members of the public who believe there will be a significant impact either on cardholder/payors or merchant/payees.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 7, 2007 at 10:00 a.m. in the auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by October 9, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Michael Hara, Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 301 are proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Paragraph 1. The authority citation for part 31 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 31.3406(g)–1(f) is amended by:

1. Revising paragraphs (f)(2)(vi)(A) and (f)(3).

2. Adding paragraph (f)(2)(vii).

The revisions and addition read as follows:

§31.3406(g)–1 Exceptions for payments to certain payees and certain other payments.

* * * * *

(f) * * *

(2) * * *

(vi) * * *

(A) The payee is a participating payee with respect to the payment and, at the time the QPCA makes the payment, the QPCA has obtained the payee's TIN and the payee's TIN has been validated through the IRS TIN Matching Program; or

* * * * *

(vii) *Participating payee.* For purposes of this section, a payee is a *participating payee* with respect to a reportable payment if—

(A) At the time the QPCA makes the payment, the payee has authorized the payment card organization to act on its behalf in furnishing its name, taxpayer identification number, and corporate status to cardholder/payors under applicable procedures issued under §601.601 of this chapter; or

(B) The payment is made before January 1, 2008.

(3) *Notifications of payee status and participation*—(i) *In general*—(A) *Nonqualified payees.* In the case of a payment to a payee other than a qualified payee (as defined in paragraph (f)(2)(vi) of this section) with respect to the payment, the QPCA acting directly or indirectly through its members, affiliates, or licensees must notify the payor that the payee is not a qualified payee. If the notification relates to a payment made after December 31, 2007, the notification must also inform the payor that IRS rules and regulations may require the payor to backup withhold on reportable payments that relate to purchases the payor makes from the payee after a specified date. The specified date to be provided in the notification is the last day of the two-month period described in paragraph (f)(1)(ii) of this section. A notification by the QPCA that a payee is not a qualified payee does not constitute notice by the IRS that the payee's TIN is incorrect for purposes of section 3406(a)(1)(B) and §31.3406(d)–5.

(B) *Nonparticipating payees.* In the case of a payment made after December 31, 2007, to a payee other than a participating payee (as defined in paragraph (f)(2)(vii) of this section), the QPCA acting directly or indirectly through its members, affiliates, or licensees must notify the payor that the payee is not a participating payee. A notification that the payee of a payment is not a participating payee must also inform the payor that IRS rules and regulations require the payor to solicit the

payee's TIN if the payor has made a reportable payment to the payee.

(C) *Due date and format.* The notifications must be furnished during the four-month period beginning on the date on which the QPCA makes the payment. Notifications may be provided in a quarterly or other regular report of payee data to the cardholder/payor and may consist of an asterisk, footnote, or other mark next to the payee's name, with the text of the notifications at the bottom of the page or at the end of the list of payee data.

(ii) *Electronic furnishing of notifications of payee status and participation*—(A) *In general.* The notifications required under paragraph (f)(3)(i) of this section may be furnished in an electronic format if the requirements of this paragraph (f)(3)(ii) are satisfied.

(B) *Consents*—(*1*) *Cardholder/Payor*—(*i*) *In general.* The cardholder/payor consent requirement must be satisfied. The cardholder/payor consent requirement is satisfied only if the QPCA has provided the disclosure statement required under paragraph (f)(3)((ii)(C) of this section to the cardholder/payor and, after receiving the disclosure statement, the cardholder/payor has affirmatively consented to receive the notifications in an electronic format. The consent may be provided electronically in any manner that reasonably demonstrates that the cardholder/payor can access the notifications in the electronic format in which they will be furnished. Alternatively, the consent may be provided in a paper document if it is confirmed electronically in a manner that reasonably demonstrates that the cardholder/payor can access the notifications in the electronic format in which they will be furnished.

(*ii*) *Withdrawal of consent.* The cardholder/payor consent requirement is not satisfied with respect to a notification if the cardholder/payor withdraws the consent and the withdrawal takes effect before the notification is furnished. Only paper notifications may be furnished to the cardholder/payor after the withdrawal takes effect. The QPCA may provide that a withdrawal of consent takes effect at any time up to 30 days after receipt by the QPCA. The QPCA may also provide that a request for paper notifications will be treated as a withdrawal of consent.

(*iii*) *Change in hardware or software requirements.* If a change in the hardware or software required to access the notifications creates a material risk that the cardholder/payor will not be able to access the notifications, the cardholder/payor consent requirement is not satisfied with respect to notifications furnished after the change unless the cardholder/payor has provided a new consent to receive the notifications in an electronic format. The new consent, whether electronic or by paper document, must be provided or confirmed in a manner that reasonably demonstrates that the cardholder/payor can access the notifications in the revised electronic format in which they will be furnished.

(*2*) *Merchant/payee*—(i) *In general.* The merchant/payee consent requirement must be satisfied. The merchant/payee consent requirement is satisfied with respect to notifications regarding a merchant/payee only if the merchant/payee has affirmatively consented to the electronic furnishing of the notifications.

(*ii*) *Withdrawal of consent.* The merchant/payee consent requirement is not satisfied with respect to a notification regarding a merchant/payee if the merchant/payee withdraws its consent and the withdrawal takes effect before the notification is furnished. The QPCA may provide that a withdrawal of consent takes effect at any time up to 30 days after receipt by the QPCA.

(C) *Required disclosures*—(*1*) *In general.* A QPCA requesting a cardholder/payor's consent to receive notifications in electronic format must provide to the cardholder/payor a clear and conspicuous disclosure statement containing each of the disclosures described in this paragraph (f)(3)(ii)(C).

(*2*) *Paper statement.* The cardholder/payor must be informed that the notifications will be furnished on paper if the cardholder/payor does not consent to receive them electronically.

(*3*) *Scope and duration of consent.* The cardholder/payor must be informed of the scope and duration of the consent. For example, the cardholder/payor must be informed whether the consent is for a specified term or will remain in effect until it is withdrawn in the manner described in paragraph (f)(3)(ii)(B)(*1*)(*ii*) of this section.

(*4*) *Post-consent request for paper notifications.* The cardholder/payor must be informed of any procedure for obtaining a paper copy of the notifications after giving the consent described in paragraph (f)(3)(ii)(B)(*1*)(*i*) of this section and whether a request for paper notifications will be treated as a withdrawal of consent.

(*5*) *Withdrawal of consent.* The cardholder/payor must be informed that—

(*i*) The cardholder/payor may withdraw a consent by writing (electronically or on paper) to the person or department whose name, mailing address, telephone number, and e-mail address is provided in the disclosure statement;

(*ii*) The QPCA will confirm the withdrawal and the date on which it takes effect in writing (either electronically or on paper); and

(*iii*) A withdrawal of consent will not apply to a notification that was furnished electronically before the date on which the withdrawal of consent takes effect.

(*6*) *Notice of termination.* The cardholder/payor must be informed of the conditions under which the QPCA will cease furnishing notifications electronically.

(*7*) *Updating information.* The cardholder/payor must be informed of the procedures for updating the information needed by the QPCA to contact the cardholder/payor. The QPCA must inform the cardholder/payor of any change in the QPCA's contact information.

(*8*) *Hardware and software requirements.* The cardholder/payor must be provided with a description of the hardware and software required to access, print, and retain the notifications.

(D) *Notice of availability*—(*1*) *In general.* If the notifications to a cardholder/payor are furnished on a website, the QPCA must also furnish a notice of availability to the cardholder/payor within 30 days after posting the notifications. The notice of availability must inform the cardholder/payor that the notifications are available on the website and must specify the date on which the notifications will no longer be available on the website. The notice of availability may be delivered by mail, electronic mail, or in person. The notice of availability must provide instructions on how to access and print the notifications and must include the following statement in capital letters, "IMPORTANT TAX DOCUMENT

AVAILABLE." If the notice of availability is provided by electronic mail, the foregoing statement must be on the subject line of the electronic mail.

(2) *Undeliverable electronic address.* If an electronic notice of availability is returned as undeliverable, and the correct electronic address cannot be obtained from the furnisher's records or from the cardholder/payor, then the furnisher must furnish the notice by mail within 30 days after the electronic notice is returned.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 4. Section 301.6724–1 is amended by revising paragraph (e)(1)(vi)(H) to read as follows:

§301.6724–1 Reasonable cause.

* * * * *

(e) * * *

(1) * * *

(vi) * * *

(H) In the case of information returns required to be filed, and information returns required to be furnished, after December 31, 2005, the filer—

(*1*) Satisfies the solicitation requirement of paragraph (e)(1)(i) of this section with respect to a payment made through a QPCA if the filer relies in good faith on the QPCA to solicit, record, validate, and furnish the payee's TIN;

(*2*) Satisfies the solicitation requirement of paragraph (e)(1)(ii) of this section with respect to a payment made through a QPCA if the filer relies in good faith on the QPCA to solicit, record, validate, and furnish the payee's TIN and does not receive notification that the payee is not a participating payee more than 30 days before the last day of the annual solicitation period; and

(*3*) Satisfies the solicitation requirement of paragraph (e)(1)(iii) of this section with respect to a payment made through a QPCA if, on or before December 31 of the year immediately succeeding the year in which the payment is made, the filer undertakes a solicitation of the payee's TIN or receives from the QPCA a TIN that the filer believes in good faith to be the payee's correct TIN.

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2007, 72 F.R. 38534)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–69

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on August 13, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

The Brewer Family Foundation
Orem, UT
Keystone Grants, Inc.
Mesa, AZ
Jeffrey and Lisa Bowen Charitable Supporting Organization
Greenville, DE
55 Whipple Street Housing Development Fund Corporation
Brooklyn, NY
The Champions Association, Inc.
Pittsburgh, PA
The Horsestone Foundation
Sandy, UT

Suspension of Tax-Exempt Status of an Organization Identified With Terrorism

Announcement 2007–70

I. Purpose

This announcement is a public notice of the suspension under section 501(p) of the Internal Revenue Code of the federal tax exemption of a certain organization that has been designated as supporting or engaging in terrorist activity or supporting terrorism. Contributions made to an organization during the period that the organization's tax-exempt status is suspended are not deductible for federal tax purposes.

II. Background

The federal government has designated a number of organizations as supporting or engaging in terrorist activity or supporting terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945. Federal law prohibits most contributions to organizations that have been so designated.

Section 501(p) of the Code was enacted as part of the Military Family Tax Relief Act of 2003 (P.L. 108–121), effective November 11, 2003. Section 501(p)(1) suspends the exemption from tax under section 501(a) of any organization

described in section 501(p)(2). An organization is described in section 501(p)(2) if the organization is designated or otherwise individually identified (1) under certain provisions of the Immigration and Nationality Act as a terrorist organization or foreign terrorist organization; (2) in or pursuant to an Executive Order which is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act of 1945 for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive Order issued under the authority of any federal law, if the organization is designated or otherwise individually identified in or pursuant to the Executive Order as supporting or engaging in terrorist activity (as defined in the Immigration and Nationality Act) or supporting terrorism (as defined in the Foreign Relations Authorization Act) and the Executive Order refers to section 501(p)(2).

Under section 501(p)(3) of the Code, suspension of an organization's tax exemption begins on the date of the first publication of a designation or identification with respect to the organization, as described above, or the date on which section 501(p) was enacted, whichever is later. This suspension continues until all designations and identifications of the organization are rescinded under the law or Executive Order under which such designation or identification was made.

Under section 501(p)(4) of the Code, no deduction is allowed under any provision of the Internal Revenue Code for any contribution to an organization during any period in which the organization's tax exemption is suspended under section 501(p). Thus, for example, no charitable contribution deduction is allowed under section 170 (relating to the income tax), section 545(b)(2) (relating to undistributed personal holding company income), section 556(b)(2) (relating to undistributed foreign personal holding company income), section 642(c) (relating to charitable set asides), section 2055 (relating to the estate tax), section 2106(a)(2) (relating to the estate tax for nonresident aliens) and section 2522 (relating to the gift tax) for contributions made to the organization during the suspension period.

On July 24, 2007, the organization listed below was designated under Executive Order 13224, entitled "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism."

III. Notice of Suspension and Non-deductibility of Contributions

The organization whose tax exemption has been suspended under section 501(p) and the effective date of such suspension are listed below. Contributions made to this organization during the period of suspension are not deductible for federal tax purposes.

Goodwill Charitable Organization Inc
f/k/a Al-Shahid Social Association
f/k/a Educational Development Association
Dearborn, MI
Effective date: 7–24–07

IV. Federal Tax Filings

An organization whose exempt status has been suspended under section 501(p) does not file Form 990 and is required to file the appropriate Federal income tax returns for the taxable periods beginning on the date of the suspension. The organization must continue to file all other appropriate federal tax returns, including employment tax returns, and may also have to file federal unemployment tax returns.

V. Contact Information

For additional information regarding the designation or identification of an organization described in section 501(p)(2), contact the Compliance Division at the Office of Foreign Assets Control of the U.S. Treasury Department at 202–622–2490. Additional information is also available for download from the Office's Internet Home Page at *www.treas.gov/offices/eotffc/ofac/index.html*

For additional information regarding the suspension of the federal tax exemption of an organization under section 501(p), contact Robert Fontenrose at (202) 283–9484 at the Internal Revenue Service.

Mortality Tables for Determining Present Value; Correction

Announcement 2007–71

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–143601–06, 2007–24 I.R.B. 1398) that was published in the Federal Register on Tuesday, May 29, 2007 (72 FR 29456) providing mortality tables to be used in determining present value or making any computation for purposes of applying certain pension funding requirements.

FOR FURTHER INFORMATION CONTACT: Bruce Perlin, Lauson C. Green, or Linda S. F. Marshall at (202) 622–6090.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–143601–06) that is the subject of these corrections is under sections 412, 430, and 431 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–143601–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–143601–06) that was the subject of FR. Doc. 07–2631 is corrected as follows:

1. On page 29457, column 3, in the preamble, line 4 of footnote number 2, the language "XLVII (1995), p. 819. The RP–2000 Mortality Table" is corrected to read "XLVII (1995), p. 819. The RP–2000 Mortality Tables".

2. On page 29460, column 3, in the preamble, second full paragraph of the column, line 7 from the bottom of the paragraph, the language "improvement factor

is equal to (1— " is corrected to read "improvement factor is equal to (1- " .

§ 1.430(h)(3)–2 [Corrected]

3. On page 29471, § 1.430(h)(3)–2(d)(4)(i)(E), column 3, last line of the paragraph, the language "§ 1.430(h)–1(a)(3))." is corrected to read "§ 1.430(h)(3)–1(a)(3))."

LaNita Van Dyke,
Branch Chief
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39770)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-72

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007

Name	Address	Designation	Date of Reinstatement
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007

Name	Address	Designation	Date of Suspension
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007

Name	Address	Designation	Date of Suspension
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007

Name	Address	Designation	Date of Suspension
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007

Name	Address	Designation	Date of Suspension
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 6033.—Returns by Exempt Organizations

26 CFR 1.6033–5T: Disclosure by tax-exempt entities that are parties to certain reportable transactions (temporary).

T.D. 9335

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Disclosure Requirements With Respect to Prohibited Tax Shelter Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 6033(a)(2) of the Internal Revenue Code (Code) that provide rules regarding the form, manner and timing of disclosure obligations with respect to prohibited tax shelter transactions to which tax-exempt entities are parties. These temporary regulations affect a broad array of tax-exempt entities, including charities, state and local government entities, Indian Tribal governments and employee benefit plans, as well as entity managers of these entities. This action is necessary to implement section 516 of the Tax Increase Prevention and Reconciliation Act of 2005. The text of the temporary regulations also serves as the text of the proposed regulations (REG–142039–06; REG–139268–06) published elsewhere in the Bulletin.

DATES: *Effective Date:* These regulations are effective on July 6, 2007.

Applicability Date: For dates of applicability, see §1.6033–5T(g).

FOR FURTHER INFORMATION CONTACT: Galina Kolomietz, (202) 622–6070, or Michael Blumenfeld, (202) 622–1124 (not toll-free numbers). For questions specifically relating to qualified pension plans, individual retirement accounts, and similar tax-favored savings arrangements, contact Dana Barry, (202) 622–6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), enacted on May 17, 2006, defines certain transactions as prohibited tax shelter transactions and imposes excise taxes and disclosure requirements with respect to prohibited tax shelter transactions to which a tax-exempt entity is a party. TIPRA creates new section 4965 and amends sections 6033(a)(2) and 6011(g) of the Code. The amended section 6033(a)(2) requires every tax-exempt entity to which section 4965 applies that is a party to a prohibited tax shelter transaction to disclose to the IRS (in such form and manner and at such time as determined by the Secretary) the following information: (a) that such entity is a party to the prohibited tax shelter transaction; and (b) the identity of any other party to the transaction which is known to the tax-exempt entity. The amended section 6011(g) requires any taxable party to a prohibited tax shelter transaction to disclose by statement to any tax-exempt entity to which section 4965 applies that is a party to such transaction that such transaction is a prohibited tax shelter transaction.

On July 11, 2006, the IRS released Notice 2006–65, 2006–31 I.R.B. 102, which alerted taxpayers to the new provisions. On February 7, 2007, the IRS released Notice 2007–18, 2007–9 I.R.B. 608, which provided interim guidance regarding the circumstances under which a tax-exempt entity will be treated as a party to a prohibited tax shelter transaction for purposes of sections 4965, 6033(a)(2) and 6011(g) and regarding the allocation to various periods of net income and proceeds attributable to a prohibited tax shelter transaction, including amounts received prior to the effective date of the section 4965 tax. See §601.601(d)(2)(ii)(*b*) of this chapter.

These temporary regulations are being issued concurrently with proposed regulations under sections 4965, 6033(a)(2) and 6011(g) published elsewhere in the Bulletin.

Explanation of Provisions

These temporary regulations contain rules concerning disclosure requirements imposed by section 6033(a)(2) on tax-exempt entities that are parties to prohibited tax shelter transactions. Proposed regulations providing rules concerning disclosure requirements under section 6033(a)(2) are being issued concurrently with these temporary regulations.

Effective Date

These temporary regulations are applicable with respect to transactions entered into by a tax-exempt entity after May 17, 2006.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these temporary regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Galina Kolomietz and Dana Barry, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the

Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6033–5T is added to read as follows:

§1.6033–5T Disclosure by tax-exempt entities that are parties to certain reportable transactions (temporary).

(a) *In general.* Every tax-exempt entity (as defined in section 4965(c)) shall file with the IRS on Form 8886–T, "*Disclosure by Tax-Exempt Entity Regarding Prohibited Tax Shelter Transaction*" (or a successor form), in accordance with this section and the instructions to the form, a disclosure of—

(1) Such entity's being a party (as defined in paragraph (b) of this section) to a prohibited tax shelter transaction (as defined in section 4965(e)); and

(2) The identity of any other party (whether taxable or tax-exempt) to such transaction that is known to the tax-exempt entity.

(b) *Definition of tax-exempt party to a prohibited tax shelter transaction*—(1) *In general.* For purposes of section 6033(a)(2), a tax-exempt entity is a party to a prohibited tax shelter transaction if the entity—

(i) Facilitates a prohibited tax shelter transaction by reason of its tax-exempt, tax indifferent or tax-favored status;

(ii) Enters into a listed transaction and the tax-exempt entity's tax return (whether an original or an amended return) reflects a reduction or elimination of its liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction; or

(iii) Is identified in published guidance, by type, class or role, as a party to a prohibited tax shelter transaction.

(2) Published guidance may identify which tax-exempt entities, by type, class or role, will not be treated as a party to a prohibited tax shelter transaction for purposes of section 6033(a)(2).

(c) *Frequency of disclosure.* A single disclosure is required for each prohibited tax shelter transaction.

(d) *By whom disclosure is made*—(1) *Tax-exempt entities referred to in section 4965(c)(1), (2) or (3).* In the case of tax-exempt entities referred to in section 4965(c)(1), (2) or (3), the disclosure required by this section must be made by the entity.

(2) *Tax-exempt entities referred to in section 4965(c)(4), (5), (6) or (7).* In the case of tax-exempt entities referred to in section 4965(c)(4), (5), (6) or (7), including a fully self-directed qualified plan, IRA, or other savings arrangement, the disclosure required by this section must be made by the entity manager (as defined in section 4965(d)(2)) of the entity.

(e) *Time and place for filing*—(1) *Tax-exempt entities described in paragraph (b)(1)(i)*—(i) *In general.* The disclosure required by this section shall be filed on or before May 15 of the calendar year following the close of the calendar year during which the tax-exempt entity entered into the prohibited tax shelter transaction.

(ii) *Subsequently listed transactions.* In the case of subsequently listed transactions (as defined in section 4965(e)(2)), the disclosure required by this section shall be filed on or before May 15 of the calendar year following the close of the calendar year during which the transaction was identified by the Secretary as a listed transaction.

(2) *Tax-exempt entities described in paragraph (b)(1)(ii).* The disclosure required by this section shall be filed on or before the date on which the first tax return (whether an original or an amended return) is filed which reflects a reduction or elimination of the tax-exempt entity's liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction.

(3) *Transition rule.* If a tax-exempt entity entered into a prohibited tax shelter transaction after May 17, 2006 and before January 1, 2007, the disclosure required by this section shall be filed—

(i) In the case of tax-exempt entities described in paragraph (b)(1)(i), on or before November 5, 2007;

(ii) In the case of tax-exempt entities described in paragraph (b)(1)(ii), on or before the later of—

(A) November 5, 2007; or

(B) The date on which the first tax return (whether an original or an amended return) is filed which reflects a reduction or elimination of the tax-exempt entity's liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction.

(4) Disclosure is not required with respect to any prohibited tax shelter transaction entered into by a tax-exempt entity on or before May 17, 2006.

(f) *Penalty for failure to provide disclosure statement.* See section 6652(c)(3) for penalties applicable to failure to disclose a prohibited tax shelter transaction in accordance with this section.

(g) *Effective date*—(1) *Applicability date.* This section applies with respect to transactions entered into by a tax-exempt entity after May 17, 2006.

(2) *Expiration date.* This section will expire on July 6, 2010.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 4. Section 301.6033–5T is added to read as follows:

§301.6033–5T Disclosure by tax-exempt entities that are parties to certain reportable transactions (temporary).

(a) *In general.* For provisions relating to the requirement of the disclosure by a tax-exempt entity that it is a party to certain reportable transactions, see §1.6033–5 of this chapter (Income Tax Regulations).

(b) *Effective date*—(1) *Applicability date.* This section applies with respect to

transactions entered into by a tax-exempt entity after May 17, 2006.

(2) Expiration date. This section will expire on July 6, 2010.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 21, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 5, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 6, 2007, 72 F.R. 36869)

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 53.6071–1: Time for filing returns.

T.D. 9334

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 53 and 54

Requirement of Return and Time for Filing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing guidance relating to the requirement of a return to accompany payment of excise taxes under section 4965 of the Internal Revenue Code (Code) and the time for filing that return. These regulations affect a broad array of tax-exempt entities, including charities, state and local government entities, Indian tribal governments and employee benefit plans, as well as entity managers of these entities. This action is necessary to implement section 516 of the Tax Increase Prevention and Reconciliation Act of 2005. The text of the temporary regulations also serves as the text of the proposed regulations (REG–142039–06; REG–139268–06) published elsewhere in the Bulletin.

DATES: *Effective date:* These regulations are effective on July 6, 2007.

Applicability date: For dates of applicability, see §§53.6071–1T(g) and 54.6011–1T(c) of these regulations.

FOR FURTHER INFORMATION CONTACT: Galina Kolomietz, (202) 622–6070, Michael Blumenfeld, (202) 622–1124, or Dana Barry, (202) 622–6060 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), enacted on May 17, 2006, added section 4965 to the Code. Section 4965 affects a broad array of tax-exempt entities as defined in section 4965(c). Tax-exempt entities described in section 4965(c)(1), (2), or (3) (referred to herein as "non-plan entities") include entities described in section 501(c), religious or apostolic associations or corporations described in section 501(d), entities described in section 170(c), including states, possessions of the United States, the District of Columbia, political subdivisions of states and political subdivisions of possessions of the United States (but not including the United States), and Indian tribal governments within the meaning of section 7701(a)(40). Tax-exempt entities described in section 4965(c)(4), (c)(5), (c)(6), or (c)(7) (referred to herein as "plan entities") include tax-favored retirement plans, individual retirement arrangements, and savings arrangements described in section 401(a), 403(a), 403(b), 529, 457(b), 408(a), 220(d), 408(b), 530 or 223(d).

Section 4965 imposes two new excise taxes, one on the tax-exempt entity (the entity-level tax) and the other on certain of the tax-exempt entity's managers (the manager-level tax). The entity-level tax is imposed on non-plan entities that are parties to prohibited tax shelter transactions. The entity-level tax does not apply to plan entities. Prohibited tax shelter transactions are transactions that are identified by the IRS as "listed transactions" (within the meaning of section 6707A(c)(2)) and reportable transactions that are confidential transactions or transactions with contractual protection (as defined in section 6707A(c)(1) and §1.6011–4(b) of this chapter).

The entity-level tax applies to each taxable year during which the non-plan entity is a party to a prohibited tax shelter transaction and has net income or proceeds attributable to the transaction which are properly allocable to that taxable year. The amount of the entity-level tax depends on whether the non-plan entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction. If the non-plan entity did not know (and did not have reason to know) that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction, the tax is the highest rate of tax under section 11 (currently 35 percent) multiplied by the greater of: (i) the entity's net income with respect to the prohibited tax shelter transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year or (ii) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction. If the non-plan entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction, the tax is the greater of (i) 100 percent of the entity's net income with respect to the transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year or (ii) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction. In the case of a transaction that becomes a prohibited tax shelter transaction by reason of becoming a listed transaction after the non-plan entity has become a party to such transaction (subsequently listed transactions), the amount of tax is based on the net income or proceeds attributable to such transaction that are properly allocable to the period beginning on the date the transaction became listed or the first day of the entity's taxable year, whichever is later. No entity-level tax applies to any income or proceeds that are

properly allocable to a period ending on or before August 15, 2006.

The manager-level tax is imposed on entity managers (as defined in section 4965(d)) of all tax-exempt entities described in section 4965(c) who approve the entity as a party (or otherwise cause the entity to be a party) to a prohibited tax shelter transaction and know or have reason to know that the transaction is a prohibited tax shelter transaction. In the case of non-plan entities, the term *entity manager* means the person with authority or responsibility similar to that exercised by an officer, director or trustee, and, with respect to any act, the person having authority or responsibility with respect to such act. In the case of plan entities, the term *entity manager* means the person who approves or otherwise causes the entity to be a party to the prohibited tax shelter transaction. An individual beneficiary (including a plan participant) or owner of the tax-favored retirement plans, individual retirement arrangements, and savings arrangements described in section 401(a), 403(a), 403(b), 529, 457(b), 408(a), 220(d), 408(b), 530 or 223(d), may be liable as an entity manager if the individual beneficiary or owner has broad investment authority under the arrangement. The amount of the manager-level tax is $20,000 for each approval or other act causing the entity to be a party to a prohibited tax shelter transaction. The manager-level tax applies separately to each entity manager.

These final and temporary regulations are being issued concurrently with proposed regulations under sections 4965, 6033(a)(2) and 6011(g) published elsewhere in the Bulletin.

Explanation of Provisions

The regulations provide that non-plan entities (including exempt organizations and governments) that are liable for section 4965 excise taxes and entity managers of non-plan entities who are liable for section 4965 excise taxes as entity managers are required to file a return on Form 4720, "*Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*." The entity return is due on or before the date the non-plan entity's annual return under section 6033(a)(1) (for example, Form 990, "*Return of Organization Exempt From Income Tax*") is due, if the non-plan entity is required to file such a return. In all other cases, the entity return is due on or before the 15th day of the fifth month after the end of the non-plan entity's accounting period for which the liability under section 4965 was incurred. In the case of a non-plan entity manager, the entity manager return is due on or before the 15th day of the fifth month following the close of the manager's taxable year during which the entity entered into a prohibited tax shelter transaction.

The regulations also provide that entity managers of plan entities who are liable for section 4965 taxes as entity managers are required to file a return on Form 5330, "*Return of Excise Taxes Related to Employee Benefit Plans*." For section 4965 taxes, the Form 5330 is due on or before the 15th day of the fifth month following the close of the manager's taxable year during which the entity entered into a prohibited tax shelter transaction.

The regulations provide a transition rule that returns of section 4965 taxes that are or were due on or before October 4, 2007 will be deemed timely if the return is filed and the tax is paid before that date.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these final and temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on business.

Drafting Information

The principal authors of these regulations are Galina Kolomietz and Dana Barry, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 53 and 54 are amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

§53.6011–1 [Amended]

Par. 2. In §53.6011–1, paragraph (b) is amended by:

1. Removing from the first sentence, the language "or 4958(a)," and adding "4958(a), or 4965(a)," in its place.

2. Removing from the last sentence, the language "or 4958(a)," and adding "4958(a), or 4965(a)," in its place.

Par. 3. Section 53.6071–1 is amended by adding and reserving paragraph (g) and adding paragraph (h) to read as follows:

§53.6071–1 Time for filing returns.

* * * * *

(g) [Reserved]. For further guidance, see §53.6071–1T(g).

(h) *Effective/applicability date.* For the applicability date of paragraph (g) of this section, see §53.6071–1T(h).

Par. 4. Section 53.6071–1T is added to read as follows:

§53.6071–1T Time for filing returns (temporary).

(a) through (f) [Reserved]. For further guidance, see §53.6071–1(a) through (f).

(g) *Taxes imposed with respect to prohibited tax shelter transactions to which tax-exempt entities are parties*—(1) *Returns by certain tax-exempt entities.* A Form 4720, "*Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*," required by §53.6011–1(b) for a tax-exempt entity described in section 4965(c)(1), (c)(2) or (c)(3) that is a party to a prohibited tax shelter transaction and is liable for tax im-

posed by section 4965(a)(1) shall be filed on or before the due date (not including extensions) for filing the tax-exempt entity's annual information return under section 6033(a)(1). If the tax-exempt entity is not required to file an annual information return under section 6033(a)(1), the Form 4720 shall be filed on or before the 15th day of the fifth month after the end of the tax-exempt entity's taxable year or, if the entity has not established a taxable year for Federal income tax purposes, the entity's annual accounting period.

(2) *Returns by entity managers of tax-exempt entities described in section 4965(c)(1), (c)(2) or (c)(3).* A Form 4720, required by §53.6011–1(b) for an entity manager of a tax-exempt entity described in section 4965(c)(1), (c)(2) or (c)(3) who is liable for tax imposed by section 4965(a)(2) shall be filed on or before the 15th day of the fifth month following the close of the entity manager's taxable year during which the entity entered into the prohibited tax shelter transaction.

(3) *Transition rule.* A Form 4720, for a section 4965 tax that is or was due on or before October 4, 2007 will be deemed to have been filed on the due date if it is filed by October 4, 2007 and if all section 4965 taxes required to be reported on that Form 4720 are paid by October 4, 2007.

(h) *Effective/applicability date*—(1) *In general.* Paragraph (g) of this section is applicable on July 6, 2007.

(2) *Expiration date.* Paragraph (g) of this section will expire on July 6, 2010.

PART 54—PENSION EXCISE TAXES

Par. 5. The authority citation for part 54 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 6. Section 54.6011–1 is amended by adding and reserving paragraph (c) and adding paragraph (d) to read as follows:

§54.6011–1 General requirement of return, statement, or list.

* * * * *

(c) [Reserved]. For further guidance, see §54.6011–1T(c).

(d) *Effective/applicability date.* For the applicability date of paragraph (c) of this section, see §54.6011–1T(d).

Par. 7. Section 54.6011–1T is amended as follows:

1. The undesignated text is designated as paragraph (a) and a paragraph heading is added.

2. Paragraph (b) is added and reserved.

3. Paragraphs (c) and (d) are added.

§54.6011–1T General requirement of return, statement or list (temporary).

(a) *Tax on reversions of qualified plan assets to employer.* * * *

(b) [Reserved].

(c) *Entity manager tax on prohibited tax shelter transactions*—(1) *In general.* Any entity manager of a tax-exempt entity described in section 4965(c)(4), (c)(5), (c)(6), or (c)(7) who is liable for tax under section 4965(a)(2) shall file a return on Form 5330, "*Return of Excise Taxes Related to Employee Benefit Plans*," on or before the 15th day of the fifth month following the close of such entity manager's taxable year during which the entity entered into the prohibited tax shelter transaction, and shall include therein the information required by such form and the instructions issued with respect thereto.

(2) *Transition rule.* A Form 5330, "*Return of Excise Taxes Related to Employee Benefit Plans*," for an excise tax under section 4965 that is or was due on or before October 4, 2007 will be deemed to have been filed on the due date if it is filed by October 4, 2007 and if the section 4965 tax that was required to be reported on that Form 5330 is paid by October 4, 2007.

(d) *Effective/applicability date*—(1) *In general.* Paragraph (c) of this section is applicable on July 6, 2007.

(2) *Expiration date.* Paragraph (c) of this section will expire on July 6, 2010.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 21, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 5, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 6, 2007, 72 F.R. 36871)

Part III. Administrative, Procedural, and Miscellaneous

2007 Section 43 Inflation Adjustment

Notice 2007–64

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 45K(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than $28 multiplied by the inflation adjustment factor for that year. The credit is phased out in any taxable year in which the reference price for the preceding calendar year exceeds $28 (as adjusted) by at least $6.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 2006 calendar year ($59.68) exceeds $28 multiplied by the inflation adjustment factor for the 2006 calendar year ($39.82) by $19.86, the enhanced oil recovery credit for qualified costs paid or incurred in 2007 is phased out completely.

Table 1 contains the GNP implicit price deflator used for the 2007 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 2006 calendar years.

Notice 2007–64 TABLE 1

GNP IMPLICIT PRICE DEFLATORS

Calendar Year	*GNP Implicit Price Deflator*	
1990	112.9	(used for 1991)
1991	117.0	(used for 1992)
1992	120.9	(used for 1993)
1993	124.1	(used for 1994)
1994	126.0	(used for 1995)*
1995	107.5	(used for 1996)
1996	109.7	(used for 1997)**
1997	112.35	(used for 1998)
1998	112.64	(used for 1999)***
1999	104.59	(used for 2000)
2000	106.89	(used for 2001)
2001	109.31	(used for 2002)
2002	110.63	(used for 2003)
2003	105.67	(used for 2004)****
2004	108.23	(used for 2005)
2005	112.129	(used for 2006)
2006	116.036	(used for 2007)

* Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

** Beginning in 1997, two digits follow the decimal point in the GNP implicit price deflator. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

**** Beginning in 2003, the GNP implicit price deflator was rebased, and the 1990 GNP implicit price deflator used to compute the 2004 § 43 inflation adjustment factor is 81.589.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2007 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for taxable years beginning in the 1991 through 2006 calendar years.

Notice 2007–64 TABLE 2

INFLATION ADJUSTMENT FACTORS AND PHASE-OUT AMOUNTS

Calendar Year	*Inflation Adjustment Factor*	*Phase-out Amount*
1991	1.0000	0
1992	1.0363	0
1993	1.0708	0
1994	1.0992	0
1995	1.1160	0
1996	1.1485	0
1997	1.1720	0
1998	1.1999	0
1999	1.2030	0
2000	1.2087	0
2001	1.2353	0
2002	1.2633	0
2003	1.2785	0
2004	1.2952	0
2005	1.3266	0
2006	1.3743	100 percent
2007	1.4222	100 percent

DRAFTING INFORMATION

The principal author of this notice is Jaime C. Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622–3110 (not a toll-free call).

2007 Marginal Production Rates

Notice 2007–65

This notice announces the applicable percentage under § 613A of the Internal Revenue Code to be used in determining percentage depletion for marginal properties for the 2007 calendar year.

Section 613A(c)(6)(C) defines the term "applicable percentage" for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage point for each whole dollar by which $20 exceeds the reference price (determined under § 45K(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 45K(d)(2)(C) for the 2006 calendar year is $59.68.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2007.

Notice 2007–65 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

Calendar Year	*Applicable Percentage*
1991	15 percent
1992	18 percent
1993	19 percent
1994	20 percent
1995	21 percent
1996	20 percent
1997	16 percent
1998	17 percent
1999	24 percent
2000	19 percent
2001	15 percent
2002	15 percent
2003	15 percent

Notice 2007–65 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION – Continued

Calendar Year	*Applicable Percentage*
2004	15 percent
2005	15 percent
2006	15 percent
2007	15 percent

The principal author of this notice is Jaime C. Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622–3110 (not a toll-free call).

Relief From Certain Low-Income Housing Credit Requirements Due to Hurricane Katrina

Notice 2007–66

I. PURPOSE

This notice is to advise owners of qualified low-income buildings and State housing credit agencies located in the Gulf Opportunity Zone (GO Zone) of relief from certain requirements under § 42 of the Internal Revenue Code. This relief is being granted pursuant to the Service's authority under § 42(n) and § 1.42–13(a) of the Income Tax Regulations.

II. BACKGROUND

Owners of qualified low-income buildings may claim a tax credit under § 42(a). For any taxable year in a 10-year credit period, the amount of credit is equal to the applicable percentage of the qualified basis of each qualified low-income building.

Under § 42(j)(1) and (2) if, at the close of any taxable year in the compliance period, the building's qualified basis with respect to the taxpayer is less than the basis as of the close of the preceding taxable year, then the taxpayer is liable for additional tax (recapture) in an amount equal to the accelerated portion of credits allowed in earlier years with respect to the reduction in qualified basis, plus interest.

Section 42(j)(4)(E) provides that the increase in tax under § 42(j) shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

Rev. Proc. 95–28, 1995–1 C.B. 704, and Rev. Proc. 2007–54, 2007–31 I.R.B. 293, which supersedes Rev. Proc. 95–28, allow temporary relief from certain requirements under § 42 to owners of qualified low-income buildings and housing credit agencies of States or possessions of the United States in major disaster areas declared by the President under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, Title 42 U.S.C. 5121–5206 (2000 and Supp. IV 2004) (Stafford Act).

Section 7.01 of Rev. Proc. 95–28, and § 7.01 of Rev. Proc. 2007–54, provide that an owner of a building that is beyond the first year of the credit period will not be subject to recapture or loss of credit if the building's qualified basis suffered a reduction because of a disaster that caused the President to issue a major disaster declaration, provided the building's qualified basis is restored within a reasonable period. Both revenue procedures provide that the housing credit agency may determine what constitutes a reasonable period for purposes of § 42(j)(4)(E), but in no instance will the period end later than 24 months after the end of the calendar year in which the President issued a major disaster declaration for the area where the building is located. If a building's qualified basis is restored within the period determined by the housing credit agency, the building will not be subject to recapture, and the building may continue to earn credit during that restoration period.

Under § 1.42–13, the Secretary may provide guidance to carry out the purposes of § 42 through various publications in the Internal Revenue Bulletin.

The Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25) (GOZA) added §§ 1400M and 1400N to the Code to provide certain tax benefits to those areas affected by Hurricane Katrina. Section 1400M(1) defines the GO Zone as that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Stafford Act by reason of Hurricane Katrina. Section 1400M(2) defines the term "Hurricane Katrina disaster area" as an area with respect to which a major disaster has been declared by the President before September 14, 2005, under section 401 of the Stafford Act by reason of Hurricane Katrina. Because of the widespread damage to housing caused by Hurricane Katrina and the difficulty in rebuilding, the Service has determined that it is appropriate to extend the restoration period provided under Rev. Proc. 95–28 for qualified low-income buildings located in the GO Zone.

III. AFFECTED PROJECTS

The reasonable restoration period for purposes of § 42(j)(4)(E) provided in this notice applies to qualified low-income buildings located in the GO Zone, as defined in § 1400M(1), that are (1) beyond the first year of the credit period, and (2) that, because of Hurricane Katrina and its aftermath, suffered a reduction in qualified basis that would cause it to be subject to recapture and loss of credit.

IV. RELIEF PROVIDED

For qualified low-income buildings subject to this notice, a housing credit agency may determine what constitutes a reasonable restoration period for purposes of § 42(j)(4)(E), but in no instance will it end later than 48 months after the end of calendar year 2005. In order to qualify for this period, the owner must have been engaged in the restoration of the building's qualified basis during the restoration period provided in § 7.01 of

Rev. Proc. 95–28. The term "engaged in the restoration of the building's qualified basis" means, with respect to the qualified low-income building, ongoing physical repairs; having entered into binding, written contracts for the repair or restoration to be completed within the restoration period; or, active negotiation of contracts for the repair or restoration, including obtaining permits for construction.

If a building's qualified basis is restored within the period determined by the housing credit agency, not to exceed 48 months, the building will not be subject to recapture, and the building may continue to earn credit during that restoration period. If the owner of the building fails to restore the building within the reasonable restoration period determined by the state housing credit agency, the owner shall lose all credit claimed during the restoration period and suffer recapture for any prior years of claimed credit under the provisions of § 42(j)(1).

The state housing credit agency may determine the appropriate period, not to extend beyond 48 months after the end of the calendar year 2005 on a building-by-building basis. Sections 7.02 through 7.04 of Rev. Proc. 95–28 continue to apply to qualified low-income buildings subject to this notice.

V. DRAFTING INFORMATION

The principal author of this notice is Jack Malgeri of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Malgeri at (202) 622–3040 (not a toll-free call).

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26 CFR 301.7508–1: Time for performing certain acts postponed by reason of service in a combat zone or a Presidentially declared disaster.
(Also: Part I, §§ 7508, 7508A; §§ 301.7508–1, 301.7508A–1.)

Rev. Proc. 2007–56

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 This revenue procedure provides an updated list of time-sensitive acts, the performance of which may be postponed under sections 7508 and 7508A of the Internal Revenue Code (Code). Section 7508 postpones specified acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces, in a combat zone, or serving with respect to a contingency operation (as defined in 10 U.S.C. § 101(a)(13)). Section 7508A permits a postponement of the time to perform specified acts for taxpayers affected by a Presidentially declared disaster or a terroristic or military action. The list of acts in this revenue procedure supplements the list of postponed acts in section 7508(a)(1) and section 301.7508A–1(c)(1)(vii) of the Procedure and Administration Regulations. Rev. Proc. 2005–27 is superseded.

.02 This revenue procedure does not, by itself, provide any postponements under section 7508A. In order for taxpayers to be entitled to a postponement of any act listed in this revenue procedure, the IRS generally will publish a notice or issue other guidance (including an IRS News Release) providing relief with respect to a Presidentially declared disaster, or a terroristic or military action. See section 4.01 of this revenue procedure.

.03 For purposes of section 7508, this revenue procedure sets forth such other acts as contemplated by section 7508(a)(1)(K). Unlike section 7508A, when a taxpayer qualifies under section 7508, all the acts listed in section 7508(a)(1) are postponed. Therefore, when a taxpayer qualifies under section 7508, the acts listed in this revenue procedure are also postponed for that taxpayer, whether or not the IRS publishes a notice or issues other guidance.

.04 This revenue procedure will be updated as needed when the IRS determines that additional acts should be included in the list of postponed acts or that certain acts should be removed from the list. Also, taxpayers may recommend that additional acts be considered for postponement under sections 7508 and 7508A. See section 19 of this revenue procedure.

.05 *Significant Changes.* When a Presidentially declared disaster occurs, the IRS guidance usually postpones the time to perform the acts in section 301.7508A–1(c)(1) as well as this revenue procedure. However, because these acts are only listed in the regulations under the disaster relief provision, when an individual qualifies for relief by virtue of service in a combat zone, the time for performing those acts are not postponed. Thus, to ensure that individuals serving in or serving in support of the Armed Forces in a combat zone or contingency operation receive a postponement of time to perform these acts this revenue procedure now includes these acts.

Certain acts, such as filing Tax Court petitions in innocent spouse and other non-deficiency cases, and making certain distributions from, contributions to, recharacterizations of, and certain transactions involving qualified retirement plans (as defined in section 4974(c)), have been added to this revenue procedure even though they are also listed as acts postponed under section 301.7508A–1(c)(1).

SECTION 2. BACKGROUND

.01 Section 7508(a)(1) of the Code permits a postponement of certain time-sensitive acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces in an area designated by the President as a combat zone under section 112(c)(2) or serving with respect to a contingency operation (as defined in 10 U.S.C. § 101(a)(13)). Among these acts are the filing of certain returns, the payment of certain taxes, the filing of a Tax Court petition for redetermination of a deficiency, and the filing of a refund claim. In the event of service in a combat zone or service with respect to a contingency operation, the acts specified in section 7508(a)(1) are automatically postponed. This revenue procedure sets forth such other acts as contemplated by section 7508(a)(1)(K). Thus, the acts listed in this revenue procedure are also automatically postponed. In addition, the Service may include acts not listed in this revenue procedure in any other published guidance (including an IRS News Release) related to the combat zone or contingency operation.

.02 Section 7508A provides that certain acts performed by taxpayers and the government may be postponed if the taxpayer is affected by a Presidentially declared disaster or a terroristic or military action. A "Presidentially declared disaster" is defined in section 1033(h)(3). A "terroristic or military action" is defined in section 692(c)(2). Section 301.7508A–1(d)(1) defines seven types of affected taxpayers,

including any individual whose principal residence (for purposes of section 1033(h)(4)) is located in a "covered disaster area" and any business entity or sole proprietor whose principal place of business is located in a "covered disaster area." Postponements under section 7508A are not available simply because a disaster or a terroristic or military action has occurred. Generally, the IRS will publish a notice or issue other guidance (including an IRS News Release) authorizing the postponement. See section 4.01 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to individuals serving in the Armed Forces of the United States in a combat zone, or serving in support of such Armed Forces, individuals serving with respect to contingency operations, affected taxpayers by reason of Presidentially declared disasters within the meaning of section 301.7508A–1(d)(1), and taxpayers whom the IRS determines are affected by a terroristic or military action. Section 17 of this revenue procedure also applies to transferors who are not affected taxpayers but who are involved in a section 1031 like-kind exchange transaction and are entitled to relief under section 17.02(2) of this revenue procedure.

SECTION 4. APPLICATION

.01 As provided by section 301.7508A–1(e), in the event of a Presidentially declared disaster or terroristic or military action, the IRS will issue a news release or other guidance authorizing the postponement of acts described in this revenue procedure and that will define which taxpayers are considered to be "affected taxpayers" and will describe the acts postponed, the duration of the postponement, and the location of the covered disaster area. See, for example, Notice 2005–73, 2005–2 C.B. 723 (summarizing the relief provided for Hurricane Katrina in news releases IR–2005–84, IR–2005–91, IR–2005–96, and IR–2005–103). The guidance may provide for postponement of only certain acts listed in this revenue procedure based on the time when the disaster occurred, its severity, and other factors. Unless the notice or other guidance for a particular disaster provides that the relief is limited, the guidance will generally postpone all of the acts listed in the regulations and this revenue procedure.

.02 Provisions of the internal revenue laws requiring the timely performance of specified acts that may be postponed under sections 7508 and 7508A are listed in the tables below. In addition, section 17 of this revenue procedure expands the categories of taxpayers qualifying for relief to include transferors of certain property and provides additional postponements of deadlines solely with respect to section 1031 like-kind exchange transactions that are affected by a Presidentially declared disaster. If an IRS News Release or other guidance is issued with respect to a specific Presidentially declared disaster and authorizes postponement of acts in this revenue procedure, affected taxpayers may use the postponement rules provided in section 17 in lieu of section 6. Transferors who are covered by the like-kind exchange rules of section 17, but who are not "affected taxpayers" as defined by the IRS News Release or other guidance or section 301.7508A–1(d)(1) are not eligible for relief under section 7508A or other sections of this revenue procedure.

.03 The following tables may, but do not necessarily, include acts specified in sections 7508 or 7508A and the regulations thereunder. Thus, for example, no mention is made in the following tables of the filing of tax returns or the payment of taxes (or an installment thereof) because these acts are already covered by sections 7508 and 7508A and the applicable regulations. Also, the following tables generally do not refer to the making of elections required to be made on tax returns or attachments thereto. Reference to these elections is not necessary because postponement of the filing of a tax return automatically postpones the making of any election required to be made on the return or an attachment thereto.

This revenue procedure, however, does include acts that are postponed under section 301.7508A–1(c)(1). The regulation lists acts that may be postponed when there has been a Presidentially declared disaster, but does not apply to postpone acts for individuals serving in, or serving in support of, the Armed Forces of the United States in a combat zone or contingency operation. For example, section 301.7508A–1(c)(1)(iii) provides a postponement for certain contributions to, distributions from qualified retirement plans. This revenue procedure also includes these acts to reflect that they are postponed for individuals serving in, or serving in support of, the Armed Forces of the United States in a combat zone or contingency operation.

.04 The following tables refer only to postponement of acts performed by taxpayers. Additional guidance will be published in the Internal Revenue Bulletin if a decision is made that acts performed by the government may be postponed under section 7508A. See, for example, Notice 2005–82, 2005–2 C.B. 978.

SECTION 5. ACCOUNTING METHODS AND PERIODS

Statute or Regulation	Act Postponed
1. Chapter 1, Subchapter E of the Code	Any act relating to the adoption, election, retention, or change of any accounting method or accounting period, or to the use of an accounting method or accounting period, that is required to be performed on or before the due date of a tax return (including extensions). Examples of such acts include (a) the requirements in Rev. Procs. 2006–45, 2006–45 I.R.B. 851, 2006–46, 2006–45 I.R.B. 859, and 2002–39, 2002–1 C.B. 1046, and 2003–62, 2003–2 C.B. 299, that Form 1128, *Application To Adopt, Change, or Retain a Tax Year*, be filed with the Director, Internal Revenue Service Center, on or before the due date (or the due date including extensions) of the tax return for the short period required to effect the change in accounting period; and (b) the requirement in Rev. Proc. 2002–9, 2002–1 C.B. 327, section 6.02(3) that a copy of *Application for Change in Accounting Method* (Form 3115) must be filed with the national office no later than when the original Form 3115 is filed with the timely filed tax return for the year of the accounting method change.
2. Treas. Reg. § 1.381(c)(4)–1(d)(2)	If the acquiring corporation is not permitted to use the method of accounting previously used by it, or the method of accounting used by the distributor/transferor corporation, or the principal method of accounting; or if the corporation wishes to use a new method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Section 1.381(c)(4)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 2005–63, 2005–2 C.B. 491, provides that applications are due by the later of (1) the last day of the tax year in which the distribution or transfer occurred, or (2) the earlier of (a) the day that is 180 days after the date of distribution or transfer, or (b) the day on which the taxpayer files its federal income tax return for the taxable year in which the distribution or transfer occurred.
3. Treas. Reg. § 1.381(c)(5)–1(d)(2)	If the acquiring corporation is not permitted to use the inventory method previously used by it, or the inventory method used by the distributor/transferor corporation, or the principal inventory method of accounting, or wishes to use a new inventory method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Section 1.381(c)(5)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 2005–63 provides that applications are due by the later of (1) the last day of the taxable year in which the distribution or transfer occurred, or (2) the earlier of (a) the day that is 180 days after the date of distribution or transfer, or (b) the day on which the taxpayer files its federal income tax return for the tax year in which the distribution or transfer occurred.
4. Treas. Reg. § 1.442–1(b)(1)	In order to secure prior approval of an adoption, change, or retention of a taxpayer's annual accounting period, the taxpayer generally must file an application on Form 1128, *Application To Adopt, Change, or Retain a Tax Year*, with the Commissioner within such time as is provided in administrative procedures published by the Commissioner from time to time. See, for example, Rev. Procs. 2006–45, 2006–46, 2002–39 and 2003–62.
5. Treas. Reg. § 1.444–3T(b)(1)	A section 444 election must be made by filing Form 8716, *Election To Have a Tax Year Other Than a Required Tax Year*, with the Service Center. Generally, Form 8716 must be filed by the earlier of (a) the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective, or (b) the due date (without regard to extensions) of the income tax return resulting from the section 444 election.
6. Treas. Reg. § 1.446–1(e)(2)(i)	Section 6 of Rev. Proc. 2002–9, at 341, allows a taxpayer to change a method of accounting within the terms of the revenue procedure by attaching the application form to the timely filed return for the year of change. Section 6.02(3)(b)(i) grants an automatic extension of 6 months within which to file an amended return with the application for the change following a timely filed original return for the year of change.

Statute or Regulation	Act Postponed
7. Treas. Reg. § 1.446–1(e)(3)(i)	To secure the Commissioner's consent to a change in method of accounting, the taxpayer must file an application on Form 3115, *Application for Change in Accounting Method*, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting (*i.e.*, must be filed by the last day of such taxable year). This filing requirement is also in Rev. Proc. 97–27, 1997–1 C.B. 680. (But see Rev. Proc. 2002–9 for automatic changes in method of accounting that can be made with the return.)
8. Sec. 451(e)	Section 451(e) permits a taxpayer using the cash receipts and disbursements method of accounting who derives income from the sale or exchange of livestock in excess of the number he would sell if he followed his usual business practices to elect (which election is deemed valid if made within the period described in section 1033(e)(2)) to include such income for the taxable year following the taxable year of such sale or exchange if, under his usual business practices, the sale or exchange would not have occurred if it were not for drought, flood, or other weather-related conditions and that such conditions resulted in the area being designated as eligible for Federal assistance.
9. Treas. Reg. § 1.461–1(c)(3)(ii)	A taxpayer may elect, with the consent of the Commissioner, to accrue real property taxes ratably in accordance with section 461(c). A written request for permission to make such an election must be submitted within 90 days after the beginning of the taxable year to which the election is first applicable. Rev. Proc. 2005–63 provides that a request to adopt the method of accounting described in § 1.461–1(c)(3)(ii) may be submitted during the taxable year in which the taxpayer desires to make the change in method of accounting.
10. Treas. Reg. § 1.7519–2T(a)(2), (3) and (4)	A partnership or S corporation must file the Form 8752, *Required Payment or Refund Under Section 7519*, if the taxpayer has made an election under section 444 to use a taxable year other than its required taxable year and the election is still in effect. The Form 8752 must be filed and any required payment must be made by the date stated in the instructions to Form 8752.
11. Rev. Proc. 92–29, Section 6.02	A developer of real estate requesting the Commissioner's consent to use the alternative cost method must file a private letter ruling request within 30 days after the close of the taxable year in which the first benefited property in the project is sold. The request must include a consent extending the period of limitation on the assessment of income tax with respect to the use of the alternative cost method.

SECTION 6. BUSINESS AND INDIVIDUAL TAX ISSUES

Statute or Regulation	Act Postponed
1. Treas. Reg. § 1.71–1T(b), Q&A-7	A payer spouse may send cash to a third party on behalf of a spouse that qualifies for alimony or separate maintenance payments if the payments are made to the third party at the written request or consent of the payee spouse. The request or consent must state that the parties intend the payment to be treated as an alimony payment to the payee spouse subject to the rules of section 71. The payer spouse must receive the request or consent prior to the date of filing of the payer spouse's first return of tax for the taxable year in which the payment was made.
2. Treas. Reg. § 1.77–1	A taxpayer who receives a loan from the Commodity Credit Corporation may elect to include the amount of the loan in his gross income for the taxable year in which the loan is received. The taxpayer in subsequent taxable years must include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Section 1.77–1 requires such requests to be filed within 90 days after the beginning of the taxable year of change. Rev. Proc. 2005–63 provides that a request for consent to adopt the method of accounting described in § 1.77–1 may be submitted during the taxable year in which the taxpayer desires to make the change in method of accounting; however, taxpayers within the scope of Rev. Proc. 2002–9 for the requested year of change that desire to make the changes in method described in § 1.77–1 must follow the procedures in Rev. Proc. 2002–9.
3. Treas. Reg. § 1.110–1(b)(4)(ii)(A)	The lessee must expend its construction allowance on the qualified long-term real property within eight and one-half months after the close of the taxable year in which the construction allowance was received.

Statute or Regulation	Act Postponed
4. Sec. 118(c)(2)	A contribution in aid of construction received by a regulated public utility that provides water or sewerage disposal services must be expended by the utility on qualifying property before the end of the second taxable year after the year in which it was received by the utility.
5. Sec. 170(f)(12)(C)	A taxpayer claiming a charitable contribution deduction of more than $500 for a gift of a qualified vehicle must obtain a written acknowledgment of the contribution by the donee organization within 30 days of the contribution or the sale of the vehicle by the donee organization, as applicable.
6. Treas. Reg. § 1.170A–5(a)(2)	A contribution of an undivided present interest in tangible personal property shall be treated as made upon receipt by the donee of a formally executed and acknowledged deed of gift. The period of initial possession by the donee may not be deferred for more than one year.
7. Sec. 172(b)(3)	A taxpayer entitled to a carryback period under section 172(b)(1) may elect to relinquish the entire carryback period with respect to a net operating loss for any taxable year. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss for which the election is to be effective.
8. Sec. 172(f)(6)	A taxpayer entitled to a 10-year carryback under section 172(b)(1)(C) (relating to certain specified liability losses) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to that section. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss.
9. Sec. 172(i)(3)	A taxpayer entitled to a 5-year carryback period under section 172(b)(1)(G) (relating to certain farming losses) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to that section. The taxpayer must make the election by the due date of the taxpayer's federal income tax return (including extensions) for the taxable year of the net operating loss.
10. Sec. 468A(g)	A taxpayer that makes payments to a nuclear decommissioning fund with respect to a taxable year must make the payments within 2½-months after the close of such taxable year (the deemed payment date).
11. Treas. Reg. § 1.468A–3(h)(1)(v)	A taxpayer must file a request for a schedule of ruling amounts for a nuclear decommissioning fund by the deemed payment date (2½-months after the close of the taxable year for which the schedule of ruling amounts is sought).
12. Treas. Reg. § 1.468A–3(h)(1)(vii)	A taxpayer has 30 days to provide additional requested information with respect to a request for a schedule of ruling amounts. If the information is not provided within the 30 days, the request will not be considered filed until the date the information is provided.
13. Sec. 529(c)(3)(C)(i)	A rollover contribution to another qualified tuition program must be made no later than the 60th day after the date of a distribution from a qualified tuition program.
14. Sec. 530(b)(5)	An individual shall be deemed to have made a contribution to a Coverdell education savings account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).
15. Sec. 530(d)(4)(C)(i)	Excess contributions (and any earnings on the excess) to a Coverdell education savings account must be distributed before the first day of the sixth month of the following taxable year.
16. Sec. 530(d)(5)	A rollover contribution to another Coverdell education savings account must be made no later than the 60th day after the date of a payment or distribution from a Coverdell education savings account.
17. Sec. 530(h)	A trustee of a Coverdell education savings account must provide certain information concerning the account to the beneficiary by January 31 following the calendar year to which the information relates. In addition, Form 5498–ESA, *Coverdell ESA Contribution Information*, must be filed with the IRS by May 31 following the calendar year to which the information relates.
18. Sec. 563(a)	In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.

Statute or Regulation	Act Postponed
19. Sec. 563(b)	In the determination of the dividends paid deduction for purposes of the personal holding company tax imposed by section 541, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the taxpayer elects in its return for the taxable year, be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.
20. Sec. 563(d)	For the purpose of applying section 562(a), with respect to distributions under subsection (a) or (b) of section 562, a distribution made after the close of the taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended.
21. Sec. 1031(a)(3)	In a deferred exchange, property otherwise qualified as like-kind property under section 1031 is treated as like-kind property if the 45-day identification period and the 180-day exchange period requirements under section 1031(a)(3) and section 1.1031(k)–1(b)(2) are met. See also section 17 of this revenue procedure.
22. Sec. 1031	Property held in a qualified exchange accommodation arrangement may qualify as "replacement property" or "relinquished property" under section 1031 if the requirements of section 4 of Rev. Proc. 2000–37, 2000–2 C.B. 308, modified by Rev. Proc. 2004–51, 2004–2 C.B. 294, are met, including the 5-business day period to enter into a qualified exchange accommodation agreement (QEAA), the 45-day identification period, the 180-day exchange period, and the 180-day combined time period. See also section 17 of this revenue procedure.
23. Sec. 1033	An election respecting the nonrecognition of gain on the involuntary conversion of property (section 1.1033(a)–2(c)(1) and (2)) is required to be made within the time periods specified in section 1.1033(a)–2(c)(3), section 1.1033(g)–1(c), section 1033(e)(2)(A), or section 1033(h)(1)(B), as applicable.
24. Sec. 1043(a)	If an eligible person (as defined under section 1043(b)) sells any property pursuant to a certificate of divestiture, then at the election of the taxpayer, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds the cost of any permitted property purchased by the taxpayer during the 60-day period beginning on the date of such sale.
25. Sec. 1045(a)	A taxpayer other than a corporation may elect to roll over gain from the sale of qualified small business stock held for more than six months if other qualified small business stock is purchased by the taxpayer during the 60-day period beginning on the date of sale.
26. Sec. 1382(d)	An organization, to which section 1382(d) applies, is required to pay a patronage dividend within 8½-months after the close of the year.
27. Sec. 1388(j)(3)(A)	Any cooperative organization that exercises its option to net patronage gains and losses, is required to give notice to its patrons of the netting by the 15th day of the 9th month following the close of the taxable year.
28. Treas. Reg. § 301.7701–3(c)	The effective date of an entity classification election (Form 8832, *Entity Classification Election*) cannot be more than 75 days prior to the date on which the election is filed.
29. Treas. Reg. § 301.9100–2(a)(1)	An automatic extension of 12 months from the due date for making a regulatory election is granted to make certain elections described in section 301.9100–2(a)(2), including the election to use other than the required taxable year under section 444, and the election to use the last-in, first out (LIFO) inventory method under section 472.
30. Treas. Reg. §§ 301.9100–2(b)–(d)	An automatic extension of 6 months from the due date of a return, excluding extensions, is granted to make the regulatory or statutory elections whose due dates are the due date of the return or the due date of the return including extensions (for example, a taxpayer has an automatic 6 month extension to file an application to change a method of accounting under Rev. Proc. 2002–9), provided the taxpayer (a) timely filed its return for the year of election, (b) within that 6-month extension period, takes the required corrective action to file the election in accordance with the statute, regulations, revenue procedure, revenue ruling, notice, or announcement permitting the election, and (c) writes at the top of the return, statement of election or other form "FILED PURSUANT TO § 301.9100–2."

Statute or Regulation	Act Postponed
1. Sec. 302(e)(1)	A corporation must complete a distribution in pursuance of a plan of partial liquidation of a corporation within the specified period.
2. Sec. 303 and Treas. Reg. § 1.303–2	A corporation must complete the distribution of property to a shareholder in redemption of all or part of the stock of the corporation which (for Federal estate tax purposes) is included in determining the estate of a decedent. Section 303 and section 1.303–2 require, among other things, that the distribution occur within the specified period.
3. Sec. 304(b)(3)(C)	If certain requirements are met, section 304(a) does not apply to a transaction involving the formation of a bank holding company. One requirement is that within a specified period (generally 2 years) after control of a bank is acquired, stock constituting control of the bank is transferred to a bank holding company in connection with the bank holding company's formation.
4. Sec. 316(b)(2)(A) and (B)(ii) and Treas. Reg. § 1.316–1(b)(2)	A personal holding company may designate as a dividend to a shareholder all or part of a distribution in complete liquidation described in section 316(b)(2)(B) and section 1.316–1(b) within 24 months after the adoption of a plan of liquidation by, *inter alia*, following the procedure provided by Treas. Reg. § 1.316–1(b)(5).
5. Sec. 332(b) and Treas. Reg. §§ 1.332–3 and 1.332–4	A corporation must completely liquidate a corporate subsidiary within the specified period.
6. Sec. 338(d)(3) and (h), and Treas. Reg. § 1.338–2	An acquiring corporation must complete a "qualified stock purchase" of a target corporation's stock within the specified acquisition period.
7. Sec. 338(g) and Treas. Reg. § 1.338–2	An acquiring corporation may elect to treat certain stock purchases as asset acquisitions. The election must be made within the specified period.
8. Sec. 338(h)(10) and Treas. Reg. § 1.338(h)(10)–1(c)	An acquiring corporation and selling group of corporations may elect to treat certain stock purchases as asset purchases, and to avoid gain or loss upon the stock sale. The election must be made within the specified period.
9. Treas. Reg. § 1.381(c)(17)–1(c)	An acquiring corporation files a Form 976, *Claim for Deficiency Dividends Deductions by a Personal Holding Company, Regulated Investment Company, or Real Estate Investment Trust*, within 120 days after the date of the determination under section 547(c) to claim a deduction of a deficiency dividend.
10. Treas. Reg. § 1.441–3(b)	A personal service corporation may obtain the approval of the Commissioner to adopt, change, or retain an annual accounting period by filing Form 1128, *Application To Adopt, Change, or Retain a Tax Year*, within such time as is provided in the administrative procedures published by the Commissioner. See Rev. Procs. 2006–46, 2006–45 I.R.B. 859, and Rev. Proc. 2002–39, 2002–1 C.B. 1046.
11. Sec. 562(b)(1)(B)	In the case of a complete liquidation (except in the case of a complete liquidation of a personal holding company) occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction.
12. Sec. 562(b)(2)	In the case of a complete liquidation of a personal holding company occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction to the extent that such is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution.

Statute or Regulation	Act Postponed
13. Sec. 597 and Treas. Reg. § 1.597–4(g)	A consolidated group of which an Institution (as defined by section 1.591–1(b)) is a subsidiary may elect irrevocably not to include the Institution in its affiliated group if the Institution is placed in Agency (as defined by section 1.591–1(b)) receivership (whether or not assets or deposit liabilities of the Institution are transferred to a Bridge Bank (as defined by section 1.591–1(b)). Except as otherwise provided in section 1.597–4(g)(6), a consolidated group makes the election by sending a written statement by certified mail to the affected Institution on or before the later of 120 days after its placement in Agency (as defined by section 1.591–1(b)) receivership or May 31, 1996.
14. Sec. 1502 and Treas. Reg. § 1.1502–75(c)(1)(i)	A common parent must apply for permission to discontinue filing consolidated returns within a specified period after the date of enactment of a law affecting the computation of tax liability.
15. Sec. 6425 and Treas. Reg. § 1.6425–1	Corporations applying for an adjustment of an overpayment of estimated income tax must file Form 4466, *Corporation Application for Quick Refund of Overpayment of Estimated Tax*, on or before the 15th day of the third month after the taxable year, or before the date the corporation first files its income tax return for such year, whichever is earlier.
16. Rev. Proc. 2003–33, Section 5	If the filer complies with the procedures set forth in the revenue procedure, including a requirement that the filer file Form 8023, *Elections Under Section 338 for Corporations Making Qualified Stock Purchases*, within the specified period, the filer gets an automatic extension under section 301.9100–3 to file an election under section 338.

SECTION 8. EMPLOYEE BENEFIT ISSUES

Statute or Regulation	Act Postponed
1. Sec. 72(p)(2)(B) and (C), and Treas. Reg. § 1.72(p)–1, Q&A-10	A loan from a qualified employer plan to a participant in, or a beneficiary of, such plan must be repaid according to certain time schedules specified in section 72(p)(2)(B) and (C) (including, if applicable, any grace period granted pursuant to section 1.72(p)–1, Q&A-10).
2. Sec. 72(t)(2)(A)(iv)	Under section 72(t)(2)(A)(iv), to avoid the imposition of a 10-percent additional tax on a distribution from a qualified retirement plan, the distribution must be part of a series of substantially equal periodic payments, made at least annually.
3. Sec. 72(t)(2)(F)	To avoid the imposition of a 10-percent additional tax on a distribution from an individual retirement arrangement (IRA) for a first-time home purchase, such distribution must be used within 120 days of the distribution to pay qualified acquisition costs or rolled into an IRA.
4. Sec. 72(t)(2)(G)	Under section 72(t)(2)(G), all or part of a distribution from a retirement plan to an individual called to active duty may be repaid into an IRA within 2 years after the active duty period ends (or later, if section 72(t)(2)(G)(iv) applies).
5. Sec. 83(b) and Treas. Reg. § 1.83–2(b)	If substantially nonvested property to which section 83 applies is transferred to any person, the service provider may elect to include the excess of the fair market value of the property over the amount paid (if any) for the property in gross income for the taxable year in which such property is transferred. This election must occur not later than 30 days after the date the property was transferred.
6. Proposed Treas. Reg. § 1.125–1, Q&A-15	Cafeteria plan participants will avoid constructive receipt of the taxable amounts if they elect the benefits they will receive before the beginning of the period during which the benefits will be provided.
7. Proposed Treas. Reg. § 1.125–1, Q&A-14 and Proposed Treas. Reg. § 1.125–2, Q&A-7	Cafeteria plan participants will not be in constructive receipt if, at the end of the plan year, they forfeit amounts elected but not used during the plan year.
8. Proposed Treas. Reg. § 1.125–2, Q&A-5	Cafeteria plan participants may receive in cash the value of unused vacation days on or before the earlier of the last day of the cafeteria plan year or the last day of the employee's taxable year to which the unused days relate.

Statute or Regulation	Act Postponed
9. Treas. Reg. § 1.162–27(e)(2)	A performance goal is considered preestablished if it is established in writing by the corporation's compensation committee not later than 90 days after the commencement of the period of service to which the performance goal relates if the outcome is substantially uncertain at the time the compensation committee actually establishes the goal. In no event, however, will the performance goal be considered pre-established if it is established after 25 percent of the period of service has elapsed.
10. Sec. 219(f)(3)	A contribution to an individual retirement account shall be deemed to have been made by the taxpayer on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed for filing the return (not including extensions thereof) for such taxable year.
11. Sec. 220(f)(5)	A rollover contribution to an Archer MSA must be made no later than the 60th day after the day on which the holder receives a payment or distribution from an Archer MSA.
12. Sec. 220(h)	A trustee or custodian of an MSA (Archer MSA or Medicare+Choice MSA) must provide certain information concerning the MSA to the account holder by January 31 following the calendar year to which the information relates. In addition, MSA contribution information must be furnished to the account holder, and Form 5498–SA filed with the IRS, by May 31 following the calendar year to which the information relates.
13. Sec. 223(f)(5)	A rollover contribution to a Health Savings Accounts (HSA) must be made no later than the 60th day after the day on which the account beneficiary receives a payment or distribution from a HSA.
14. Sec. 223(h)	A trustee or custodian of a HSA must provide certain information concerning the HSA to the account beneficiary by January 31 following the calendar year to which the information relates. In addition, HSA contribution information must be furnished to the account beneficiary, and Form 5498–SA filed with the IRS, by May 31 following the calendar year to which the information relates.
15. Secs. 401(a)(9), 403(a)(1), 403(b)(10), 408(a)(6), 408(b)(3) and 457(d)(2), and Treas. Reg. § 1.401(a)(9)–4 & 1.401(a)(9)–8, Q&A-2	The first required minimum distribution from plans subject to the rules in section 401(a)(9) must be made no later than the required beginning date. Subsequent required minimum distributions must be made by the end of each distribution calendar year.
16. Sec. 401(a)(28)(B)(i)	A qualified participant in an ESOP (as defined in section 401(a)(28)(B)(iii)) may elect within 90 days after the close of each plan year in the qualified election period (as defined in section 401(a)(28)(B)(iv)) to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (50 percent in the case of the last election).
17. Sec. 401(a)(28)(B)(ii)	A plan must distribute the portion of the participant's account covered by an election under section 401(a)(28)(B)(i) within 90 days after the period during which an election can be made; or the plan must offer at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making the election under section 401(a)(28)(B)(i) and within 90 days after the period during which the election may be made, the plan must invest the portion of the participant's account in accordance with the participant's election.
18. Sec. 401(a)(30) and Treas. Reg. § 1.401(a)–30 and § 1.402(g)–1	Excess deferrals for a calendar year, plus income attributable to the excess, must be distributed no later than the first April 15 following the calendar year.
19. Sec. 401(b) and Treas. Reg. § 1.401(b)–1	A retirement plan that fails to satisfy the requirements of section 401(a) or section 403(a) on any day because of a disqualifying provision will be treated as satisfying such requirements on such day if, prior to the expiration of the applicable remedial amendment period, all plan provisions necessary to satisfy the requirements of section 401(a) or 403(a) are in effect and have been made effective for the whole of such period.
20. Sec. 401(k)(8)	A cash or deferred arrangement must distribute excess contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the arrangement no later than the close of the following plan year.

Statute or Regulation	Act Postponed
21. Sec. 401(m)(6)	A plan subject to section 401(m) must distribute excess aggregate contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the plan no later than the close of the following plan year.
22. Secs. 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)(B)	An eligible rollover distribution may be rolled over to an eligible retirement plan no later than the 60th day following the day the distributee received the distributed property. A similar rule applies to IRAs.
23. Sec. 402(g)(2)(A) and Treas. Reg. § 1.402(g)–1	An individual with excess deferrals for a taxable year must notify a plan, not later than a specified date following the taxable year that excess deferrals have been contributed to that plan for the taxable year. A distribution of excess deferrals identified by the individual, plus income attributable to the excess, must be accomplished no later than the first April 15 following the taxable year of the excess.
24. Secs. 404(a)(6), 404(h)(1)(B), and 404(m)(2)	A contribution to a qualified retirement plan (other than an individual retirement account) shall be deemed to have been made by the taxpayer on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed for filing the return for such taxable year.
25. Sec. 404(k)(2)(A)(ii)	An ESOP receiving dividends on stock of the C corporation maintaining the plan must distribute the dividend in cash to participants or beneficiaries not later than 90 days after the close of the plan year in which the dividend was paid.
26. Sec. 408(d)(4)	A distribution of any contribution made for a taxable year to an individual retirement or for an individual retirement annuity shall be included in gross income unless such distribution (and attributable earnings) is received on or before the day prescribed by law (including extensions of time) for filing such individual's return for such taxable year.
27. Sec. 408A(d)(6)(A)	If, on or before the date prescribed by law (including extensions of time) for filing the taxpayer's return for such taxable year, a taxpayer transfers in a trustee-to-trustee transfer any contribution to an individual retirement plan made during such taxable year from such plan to any other individual retirement plan, then such contribution shall be treated as having been made to the transferee plan (and not the transferor plan).
28. Secs. 408(i) and 6047(c)	A trustee or issuer of an individual retirement arrangement (IRA) must provide certain information concerning the IRA to the IRA owner by January 31 following the calendar year to which the information relates. In addition, IRA contribution information must be furnished to the owner, and Form 5498 filed with the IRS, by May 31 following the calendar year to which the information relates.
29. Sec. 409(h)(4)	An employer required to repurchase employer securities under section 409(h)(1)(B) must provide a put option for a period of at least 60 days following the date of distribution of employer securities to a participant, and if the put option is not exercised, for an additional 60-day period in the following plan year. A participant who receives a distribution of employer securities under section 409(h)(1)(B) must exercise the put option provided by that section within a period of at least 60 days following the date of distribution, or if the put option is not exercised within that period, for an additional 60-day period in the following plan year.
30. Sec. 409(h)(5)	An employer required to repurchase employer securities distributed as part of a total distribution must pay for the securities in substantially equal periodic payments (at least annually) over a period beginning not later than 30 days after the exercise of the put option and not exceeding 5 years.
31. Sec. 409(h)(6)	An employer required to repurchase employer securities distributed as part of an installment distribution must pay for the securities not later than 30 days after the exercise of the put option under section 409(h)(4).
32. Sec. 409(o)	An ESOP must commence the distribution of a participant's account balance, if the participant elects, not later than 1 year after the close of the plan year — i) in which the participant separates from service by reason of attaining normal retirement age under the plan, death or disability; or ii) which is the 5th plan year following the plan year in which the participant otherwise separates from service (except if the participant is reemployed before distribution is required to begin).

Statute or Regulation	Act Postponed
33. Sec. 1042(a)(2)	A taxpayer must purchase qualified replacement property (defined in section 1042(c)(4)) within the replacement period, defined in section 1042(c)(3) as the period which begins 3 months before the date of the sale of qualified securities to an ESOP and ends 12 months after the date of such sale.
34. Sec. 4972(c)(3)	Nondeductible plan contributions must be distributed prior to a certain date to avoid a 10 percent tax.
35. Sec. 4979 and Treas. Reg. § 54.4979–1	A 10 percent tax on the amount of excess contributions and excess aggregate contributions under a plan for a plan year will be imposed unless the excess, plus income attributable to the excess is distributed (or, if forfeitable, forfeited) no later than 2½-months after the close of the plan year. In the case of an employer maintaining a SARSEP, employees must be notified of the excess by the employer within the 2½-month period to avoid the tax.
36. Secs. 6033, 6039D, 6047, 6057, 6058, and 6059	Form 5500, *Annual Return/Report of Employee Benefit Plan*, and Form 5500–EZ, *Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan*, which are used to report annual information concerning employee benefit plans and fringe benefit plans, must be filed by a specified time. *General Advice* Affected filers are advised to follow the instructions accompanying the Form 5500 series (or other guidance published on the postponement) regarding how to file the forms when postponements are granted pursuant to section 7508 or section 7508A. *Combat Zone Postponements under Section 7508* Individual taxpayers who meet the requirements of section 7508 are entitled to a postponement of time to file the Form 5500 or Form 5500–EZ under section 7508. The postponement of the Form 5500 series filing due date under section 7508 will also be permitted by the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC) for similarly situated individuals who are plan administrators. *Postponements for Presidentially-Declared Disasters and Terroristic or Military Actions under Section 7508A* In the case of "affected taxpayers," as defined in section 301.7508A–1(d), the IRS may permit a postponement of the filing of the Form 5500 or Form 5500–EZ. Taxpayers who are unable to obtain on a timely basis information necessary for completing the forms from a bank, insurance company, or any other service provider because such service providers' operations are located in a covered disaster area will be treated as "affected taxpayers." Whatever postponement of the Form 5500 series filing due date is permitted by the IRS under section 7508A will also be permitted by the Department of Labor and PBGC for similarly situated plan administrators and direct filing entities.
37. Rev. Proc. 2006–27, Sections 9.02(1) and (2)	The correction period for self-correction of operational failures is the last day of the second plan year following the plan year for which the failure occurred. The correction period for self-correction of operational failures for transferred assets does not end until the last day of the first plan year that begins after the corporate merger, acquisition, or other similar employer transaction.
38. Rev. Proc. 2006–27, 2003–44, Section 12.07	If the submission involves a plan with transferred assets and no new incidents of the failures in the submission occurred after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the plan sponsor may calculate the amount of plan assets and number of plan participants based on the Form 5500 information that would have been filed by the plan sponsor for the plan year that includes the employer transaction if the transferred assets were maintained as a separate plan.
39. Rev. Proc. 2006–27, Section 14.03	If an examination involves a plan with transferred assets and the IRS determines that no new incidents of the failures that relate to the transferred assets occurred after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction, the sanction under Audit CAP will not exceed the sanction that would apply if the transferred assets were maintained as a separate plan.

SECTION 9. ESTATE, GIFT AND TRUST ISSUES

Statute or Regulation	Act Postponed
1. Sec. 643(g)	The trustee may elect to treat certain payments of estimated tax as paid by the beneficiary. The election shall be made on or before the 65th day after the close of the taxable year of the trust.
2. Sec. 645 and Treas. Reg. § 1.645–1(c)	An election to treat a qualified revocable trust as part of the decedent's estate must be made by filing Form 8855, *Election To Treat a Qualified Revocable Trust as Part of an Estate*, by the due date (including extensions) of the estate's Federal income tax return for the estate's first taxable year, if there is an executor, or by the due date (including extensions) of the trust's Federal income tax return for the trust's first taxable year (treating the trust as an estate), if there is no executor.
3. Sec. 663(b) and Treas. Reg. § 1.663(b)–2	The fiduciary of a trust or estate may elect to treat any amount properly paid or credited to a beneficiary within the first 65 days following the close of the taxable year as an amount that was properly paid or credited on the last day of such taxable year. If a return is required to be filed for the taxable year for which the election is made, the election shall be made on such return no later than the time for making such return (including extensions). If no return is required to be filed, the election shall be made in a separate statement filed with the internal revenue office with which a return would have been filed, no later than the time for making a return (including extensions).
4. Sec. 2011(c)	The executor of a decedent's estate must file a claim for a credit for state estate, inheritance, legacy or succession taxes by filing a claim within 4 years of filing Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return.* (Section 2011 does not apply to estates of decedents dying after December 31, 2004; see section 2058).
5. Sec. 2014(e)	The executor of a decedent's estate must file a claim for foreign death taxes within 4 years of filing Form 706.
6. Sec. 2016 and Treas. Reg. § 20.2016–1	If an executor of a decedent's estate (or any other person) receives a refund of any state or foreign death taxes claimed as a credit on Form 706, the IRS must be notified within 30 days of receipt. (Section 2016 is amended effective for estates of decedents dying after December 31, 2004; see section 2058).
7. Sec. 2031(c)	If an executor of a decedent's estate elects on Form 706 to exclude a portion of the value of land that is subject to a qualified conservation easement, agreements relating to development rights must be implemented within 2 years after the date of the decedent's death.
8. Sec. 2032(d)	The executor of a decedent's estate may elect an alternate valuation on a late filed Form 706 if the Form 706 is not filed later than 1 year after the due date.
9. Sec. 2032A(c)(7)	A qualified heir, with respect to specially valued property, is provided a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax.
10. Sec. 2032A(d)(3)	The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property.
11. Sec. 2046	A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21.
12. Sec. 2053(d) and Treas. Reg. §§ 20.2053–9(c) and 10(c)	If the executor of a decedent's estate elects to take a deduction for state and foreign death tax imposed upon a transfer for charitable or other uses, the executor must file a written notification to that effect with the IRS before expiration of the period of limitations on assessments (generally 3 years). (Section 2053 is amended effective for estates of decedents dying after December 31, 2004, to apply only with respect to foreign death taxes).
13. Sec. 2055(e)(3)	A party in interest must commence a judicial proceeding to change an interest into a qualified interest no later than the 90th day after the estate tax return (Form 706) is required to be filed or, if no return is required, the last date for filing the income tax return for the first taxable year of the trust.

Statute or Regulation	Act Postponed
14. Sec. 2056(d)	A qualified domestic trust (QDOT) election must be made on Form 706, Schedule M, and the property must be transferred to the trust before the date on which the return is made. Any reformation to determine if a trust is a QDOT requires that the judicial proceeding be commenced on or before the due date for filing the return.
15. Sec. 2056A(b)(2)	The trustee of a QDOT must file a claim for refund of excess tax no later than 1 year after the date of final determination of the decedent's estate tax liability.
16. Sec. 2057(i)(3)(G)	A qualified heir, with respect to qualified family owned business, has a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax. (The section 2057 election is not available to estates of decedents dying after December 31, 2004).
17. Sec. 2057(i)(3)(H)	The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property.
18. Sec. 2058(b)	The executor of a decedent's estate may deduct estate, inheritance, legacy, or succession taxes actually paid to any state or the District of Columbia from the decedent's gross estate. With certain exceptions, the deduction is only allowed provided the taxes are actually paid and the deduction claimed within 4 years of filing Form 706.
19. Sec. 2516	The IRS will treat certain transfers as made for full and adequate consideration in money or money's worth where husband and wife enter into a written agreement relative to their marital and property rights and divorce actually occurs within the 3-year period beginning on the date 1 year before such agreement is entered into.
20. Sec. 2518(b)	A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21.

SECTION 10. EXEMPT ORGANIZATION ISSUES

Statute or Regulation	Act Postponed
1. Sec. 501(h)	Under section 501(h), certain eligible 501(c)(3) organizations may elect on Form 5768, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation*, to have their legislative activities measured solely by expenditures. Form 5768 is effective beginning with a taxable period, provided it is filed before the end of the organization's taxable period.
2. Sec. 505(c)(1)	An organization must give notice by filing Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, to be recognized as an organization exempt under section 501(c)(9) or section 501(c)(17). Generally, if the exemption is to apply for any period before the giving of the notice, section 1.505(c)–1T, Q&A-6, of the regulations requires that Form 1024 be filed within 15 months from the end of the month in which the organization was organized.
3. Sec. 508 and Treas. Reg. § 1.508–1	A purported section 501(c)(3) organization must generally file Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, to qualify for exemption. Generally, if the exemption is to apply for any period before the giving of the notice, the Form 1023 must be filed within 15 months from the end of the month in which the organization was organized.
4. Sec. 527(i)(2)	Certain political organizations shall not be treated as tax-exempt section 527 organizations unless each such organization electronically files a notice (Form 8871, *Political Organization Notice of Section 527 Status*) not less than 24 hours after the date on which the organization is established, or, in the case of a material change in the information required, not later than 30 days after such material change.

Statute or Regulation	Act Postponed
5. Sec. 527(j)(2)	Under section 527(j)(2), certain tax-exempt political organizations that accept contributions or make expenditures for an exempt function under section 527 during a calendar year are required to file periodic reports on Form 8872, *Political Organization Report of Contributions and Expenditures*, beginning with the first month or quarter in which they accept contributions or make expenditures, unless excepted. In addition, tax-exempt political organizations that make contributions or expenditures with respect to an election for federal office may be required to file pre-election reports for that election. A tax-exempt political organization that does not file the required Form 8872, or that fails to include the required information, must pay an amount calculated by multiplying the amount of the contributions or expenditures that are not disclosed by the highest corporate tax rate.
6. Sec. 6033(g)(1) and Treas. Reg. § 1.6033–2(e)	Annual information returns, Forms 990, *Return of Organization Exempt From Income Tax*, of certain tax-exempt political organizations described under section 527 must be filed on or before the 15th day of the 5th month following the close of the taxable year.
7. Sec. 6034 and Treas. Reg. § 1.6034–1(c)	Annual information returns, Forms 1041–A, *U.S. Information Return Trust Accumulation of Charitable Amounts*, of trusts claiming charitable or other deductions under section 642(c) must be filed on or before the 15th day of the 4th month following the close of the taxable year of the trust.
8. Sec. 6072(e) and Treas. Reg. § 1.6033–2(e)	Annual returns of organizations exempt or treated in the same manner as organizations exempt from tax under section 501(a) must be filed on or before the 15th day of the 5th month following the close of the taxable year.
9. Rev. Proc. 80–27, Section 6.01	The central organization of a group ruling is required to report information regarding the status of members of the group annually (at least 90 days before the close of its annual accounting period).

SECTION 11. EXCISE TAX ISSUES

Statute or Regulation	Act Postponed
1. Treas. Reg. § 48.4101–1(h)(v)	A registrant must notify the IRS of any change in the information a registrant has submitted within 10 days.
2. Sec. 4101(d) and Treas. Reg. § 48.4101–2	Each information return under section 4101(d) must be filed by the last day of the first month following the month for which the report is made.
3. Sec. 4221(b) and Treas. Reg. § 48.4221–2(c)	A manufacturer is allowed to make a tax-free sale of articles for resale to a second purchaser for use in further manufacture. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.
4. Sec. 4221(b) and Treas. Reg. § 48.4221–3(c)	A manufacturer is allowed to make a tax-free sale of articles for export. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.
5. Sec. 4221(e)(2)(A) and Treas. Reg. § 48.4221–7(c)	A manufacturer is allowed to make a tax-free sale of tires for use by the purchaser in connection with the sale of another article manufactured or produced by the purchaser. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof.

SECTION 12. INTERNATIONAL ISSUES

Statute or Regulation	Act Postponed
1. Sec. 482 and Treas. Reg. § 1.482–1(g)(4)(ii)(C)	A claim for a setoff of a section 482 allocation by the IRS must be filed within 30 days of either the date of the IRS's letter transmitting an examination report with notice of the proposed adjustment or the date of a notice of deficiency.
2. Sec. 482 and Treas. Reg. § 1.482–1(j)(2)	A claim for retroactive application of the final section 482 regulations, otherwise effective only for taxable years beginning after October 6, 1994, must be filed prior to the expiration of the statute of limitations for the year for which retroactive application is sought.

Statute or Regulation	Act Postponed
3. Sec. 482 and Treas. Reg. § 1.482–7(j)(2)	A participant in a cost-sharing arrangement must provide documentation regarding the arrangement, as well as documentation specified in sections 1.482–7(b)(4) and 1.482–7(c)(1), within 30 days of a request by the IRS.
4. Treas. Reg. § 1.882–5(d)(2)(ii)(A)(2)	Liabilities of a foreign corporation that is not a bank must be entered on a set of books at a time reasonably contemporaneous with the time the liabilities are incurred.
5. Treas. Reg. § 1.882–5(d)(2)(iii)(A)(1)	Liabilities of foreign corporations that are engaged in a banking business must be entered on a set of books relating to an activity that produces ECI before the close of the day on which the liability is incurred.
6. Treas. Reg. § 1.884–2T(b)(3)(i)	Requirement that marketable securities be identified on the books of a U.S. trade or business within 30 days of the date an equivalent amount of U.S. assets ceases to be U.S. assets. This requirement applies when a taxpayer has elected to be treated as remaining engaged in a U.S. trade or business for branch profits tax purposes.
7. Treas. Reg. § 1.884–4(b)(3)(ii)(B)	Requirement that a foreign corporation which identifies liabilities as giving rise to U.S. branch interest, send a statement to the recipients of such interest within two months of the end of the calendar year in which the interest was paid, stating that such interest was U.S. source income (if the corporation did not make a return pursuant to section 6049 with respect to the interest payment).
8. Treas. Reg. § 1.922–1(i) (Q&A-13)	The quarterly income statements for the first three quarters of the FSC year must be maintained at the FSC's office no later than 90 days after the end of the quarter. The quarterly income statement for the fourth quarter of the FSC year, the final year-end income statement, the year-end balance sheet, and the final invoices (or summaries) or statements of account must be maintained at the FSC's office no later than the due date, including extensions, of the FSC tax return for the applicable taxable year.
9. Sec. 922(a)(1)(E) and Treas. Reg. § 1.922–1(j) (Q&A-19)	The FSC must appoint a new non-U.S. resident director within 30 days of the date of death, resignation, or removal of the former director, in the event that the sole non-U.S. resident director of a FSC dies, resigns, or is removed.
10. Sec. 924(b)(2)(B) and Treas. Reg. § 1.924(a)–1T(j)(2)(i)	A taxpayer must execute an agreement regarding unequal apportionment at a time when at least 12 months remain in the period of limitations (including extensions) for assessment of tax with respect to each shareholder of the small FSC in order to apportion unequally among shareholders of a small FSC the $5 million foreign trading gross receipts used to determine exempt foreign trade income.
11. Sec. 924(c)(2) and Treas. Reg. § 1.924(c)–1(c)(4)	The FSC must open a new qualifying foreign bank account within 30 days of the date of termination of the original bank account, if a FSC's qualifying foreign bank account terminates during the taxable year due to circumstances beyond the control of the FSC.
12. Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(1)	The FSC must transfer funds from its foreign bank account to its U.S. bank account, equal to the dividends, salaries, or fees disbursed, and such transfer must take place within 12 months of the date of the original disbursement from the U.S. bank account, if dividends, salaries, or fees are disbursed from a FSC's U.S. bank account.
13. Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(2)	The FSC must reimburse from its own bank account any dividends or other expenses that are paid by a related person, on or before the due date (including extensions) of the FSC's tax return for the taxable year to which the reimbursement relates.
14. Sec. 924(c)(3) and Treas. Reg. § 1.924(c)–1(d)(3)	If the Commissioner determines that the taxpayer acted in good faith, the taxpayer may comply with the reimbursement requirement by reimbursing the funds within 90 days of the date of the Commissioner's determination, notwithstanding a taxpayer's failure to meet the return-filing-date reimbursement deadline in section 1.924(c)–1(d)(2).
15. Sec. 924(e)(4) and Treas. Reg. § 1.924(e)–1(d)(2)(iii)	If a payment with respect to a transaction is made directly to the FSC or the related supplier in the United States, the funds must be transferred to and received by the FSC bank account outside the United States no later than 35 days after the receipt of good funds (*i.e.*, date of check clearance) on the transaction.

Statute or Regulation	Act Postponed
16. Temp. Treas. Reg. § 1.925(a)–1T(e)(4)	A FSC and its related supplier may redetermine a transfer pricing method, the amount of foreign trading gross receipts, and costs and expenses, provided such redetermination occurs before the expiration of the statute of limitations for claims for refund for both the FSC and related supplier, and provided the statute of limitations for assessment applicable to the party that has a deficiency in tax on account of the redetermination is open. See Treas. Reg. § 1.925(a)–1(c)(8)(i) for time limitations with respect to FSC administrative pricing grouping redeterminations and for a cross-reference to section 1.925(a)–1T(e)(4).
17. Sec. 927(f)(3)(A) and Treas. Reg. § 1.927(f)–1(b) (Q&A-12)	A corporation may terminate its election to be treated as a FSC or a small FSC by revoking the election during the first 90 days of the FSC taxable year (other than the first year in which the election is effective) in which the revocation was to take effect.
18. Sec. 927 and Temp. Treas. Reg. § 1.927(a)–1T (d)(2)(i)(B)	A taxpayer may satisfy the destination test with respect to property sold or leased by a seller or lessor if such property is delivered by the seller or lessor (or an agent of the seller or lessor) within the United States to a purchaser or lessee, if the property is ultimately delivered outside the United States (including delivery to a carrier or freight forwarder for delivery outside the United States) by the purchaser or lessee (or a subsequent purchaser or sublessee) within one year after the sale or lease.
19. Sec. 927 and Temp. Treas. Reg. § 1.927(b)–1T(e)(2)(i)	A taxpayer that claims FSC commission deductions must designate the sales, leases, or rentals subject to the FSC commission agreement no later than the due date (as extended) of the tax return of the FSC for the taxable year in which the transaction(s) occurred.
20. Sec. 927 and Treas. Reg. § 1.927(f)–1(a) (Q&A 4)	A transferee or other recipient of shares in the corporation (other than a shareholder that previously consented to the election) must consent to be bound by the prior election within 90 days of the first day of the FSC's taxable year to preserve the status of a corporation that previously qualified as a FSC or as a small FSC.
21. Sec. 936 and Treas. Reg. § 1.936–11	A taxpayer that elects retroactive application of the regulation regarding separate lines of business for taxable years beginning after December 31, 1995, must elect to do so prior to the expiration of the statute of limitations for the year in question.
22. Treas. Reg. §§ 1.964–1T(c)(3)	An election, adoption or change in a method of accounting or tax year on behalf of a CFC or noncontrolled section 902 corporation by its controlling domestic shareholders requires the filing of a statement with the shareholder's return for its year with or within which ends the foreign corporation's taxable year for which the election is made or the method or tax year is adopted or changed, and the filing of a written notice on or before the filing date of the shareholder's return.
23. Sec. 982(c)(2)(A)	Any person to whom a formal document request is mailed shall have the right to bring a proceeding to quash such request not later than the 90th day after the day such request was mailed.
24. Treas. Reg. § 1.988–1(a)(7)(ii)	An election to have section 1.988–1(a)(2)(iii) apply to regulated futures contracts and nonequity options must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the taxpayer holds a contract described in section 988(c)(1)(D)(ii) and section 1.988–1(a)(7)(ii). A late election may be made within 30 days after the time prescribed for the election.
25. Sec. 988(c)(1)(E)(iii)(V) (qualified fund) and Treas. Reg. § 1.988–1(a)(8)(i)(E)	A qualified fund election must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the partnership holds an instrument described in section 988(c)(1)(E)(i).
26. Treas. Reg. § 1.988–3(b)	An election to treat (under certain circumstances) any gain or loss recognized on a contract described in section 1.988–2(d)(1) as capital gain or loss must be made by clearly identifying such transaction on taxpayer's books and records on the date the transaction is entered into.
27. Treas. Reg. § 1.988–5(a)(8)(i)	Taxpayer must establish a record, and before the close of the date the hedge is entered into, the taxpayer must enter into the record for each qualified hedging transaction the information contained in sections 1.988–5(a)(8)(i)(A) through (E).
28. Treas. Reg. § 1.988–5(b)(3)(i)	Taxpayer must establish a record and before the close of the date the hedge is entered into, the taxpayer must enter into the record a clear description of the executory contract and the hedge.

Statute or Regulation	Act Postponed
29. Treas. Reg. § 1.988–5(c)(2)	Taxpayer must identify a hedge and underlying stock or security under the rules of section 1.988–5(b)(3).
30. Sec. 991	A corporation that elects IC-DISC treatment (other than in the corporation's first taxable year) must file Form 4876–A, *Election To Be Treated as an Interest Charge DISC*, with the regional service center during the 90-day period prior to the beginning of the tax year in which the election is to take effect.
31. Sec. 991 and Treas. Reg. § 1.991–2(g)(2)	A corporation that filed a tax return as a DISC, but subsequently determines that it does not wish to be treated as a DISC, must notify the Commissioner more than 30 days before the expiration of period of limitations on assessment applicable to the tax year.
32. Sec. 992 and Treas. Reg. § 1.992–2(a)(1)(i)	A qualifying corporation must file Form 4876–A or attachments thereto, containing the consent of every shareholder of the corporation to be treated as a DISC as of the beginning of the corporation's first taxable year.
33. Sec. 992 and Treas. Reg. § 1.992–2(e)(2)	A corporation seeking to revoke a prior election to be treated as a DISC, must file a statement within the first 90 days of the taxable year in which the revocation is to take effect with the service center with which it filed the election or, if the corporation filed an annual information return, by filing the statement at the service center with which it filed its most recent annual information return.
34. Sec. 992 and Treas. Reg. § 1.992–3(c)(3)	A DISC that makes a deficiency distribution with respect to the 95 percent of gross receipts test or the 95 percent assets test, or both tests, for a particular taxable year, must make such distribution within 90 days of the date of the first written notification from the IRS that the DISC failed to satisfy such test(s).
35. Sec. 993 and Treas. Reg. § 1.993–3(d)(2)(i)(b)	In certain cases, property may not qualify as export property for DISC purposes unless, among other things, such property is ultimately delivered, directly used, or directly consumed outside the U.S. within one year of the date of sale or lease of the property.
36. Sec. 1445 Treas. Reg. § 1.1445–1	Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, must be filed by a buyer or other transferee of a U.S. real property interest, and a corporation, partnership, or fiduciary that is required to withhold tax. The amount withheld is to be transmitted with Form 8288, which is generally to be filed by the 20th day after the date of transfer.
37. Sec. 1446	All partnerships with effectively connected gross income allocable to a foreign partner in any tax year must file Forms 8804, *Annual Return for Partnership Withholding Tax (Section 1446)*, and 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax*, on or before the 15th day of the 4th month following the close of the partnership's taxable year.
38. Sec. 1446	Form 8813, *Partnership Withholding Tax Payment Voucher (Section 1446)*, is used to pay the withholding tax under section 1446 for all partnerships with effectively connected gross income allocable to a foreign partner in any tax year. Form 8813, *Partnership Withholding Tax Payment Voucher (Section 1446)*, must accompany each payment of section 1446 tax made during the partnership's taxable year. Form 8813 is to be filed on or before the 15th day of the 4th, 6th, 9th, and 12th months of the partnership's taxable year for U.S. income tax purposes.
39. Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A–4(d)(1)	A reporting corporation must cure any failure to furnish information or failure to maintain records within 90 days after the IRS gives notice of the failure to avoid the continuation penalty.
40. Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A–4(d)(1)	A reporting corporation must cure any failure to furnish information or failure to maintain records before the beginning of each 30-day period after expiration of the initial 90-day period to avoid additional continuation penalties.
41. Sec. 6038A(a) and Treas. Reg. § 1.6038A–2(d)	A reporting corporation must file a duplicate Form 5472 at the same time it files its income tax return unless Form 5472 is filed electronically.
42. Sec. 6038A(e)(1) and Treas. Reg. § 1.6038A–5(b)	A reporting corporation must furnish an authorization of agent within 30 days of a request by the IRS to avoid a penalty.
43. Sec. 6038A(e)(4)(A)	A reporting corporation must commence any proceeding to quash a summons filed by the IRS in connection with an information request within 90 days of the date the summons is issued.

Statute or Regulation	Act Postponed
44. Sec. 6038A(e)(4)(B)	A reporting corporation must commence any proceeding to review the IRS's determination of noncompliance with a summons within 90 days of the IRS's notice of noncompliance.
45. Sec. 6038A and Treas. Reg. § 1.6038A–3(b)(3)	A reporting corporation must supply an English translation of records provided pursuant to a request for production within 30 days of a request by the IRS for a translation to avoid a penalty.
46. Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(2)	A reporting corporation must, within 60 days of a request by the IRS for records maintained outside the United States, either provide the records to the IRS, or move them to the United States and provide the IRS with an index to the records to avoid a penalty.
47. Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(2)(i)	A reporting corporation must supply English translations of documents maintained outside the United States within 30 days of a request by the IRS for translation to avoid a penalty.
48. Sec. 6038A and Treas. Reg. § 1.6038A–3(f)(4)	A reporting corporation must request an extension of time to produce or translate documents maintained outside the United States beyond the period specified in the regulations within 30 days of a request by the IRS to avoid a penalty.
49. Secs. 6038, 6038B, and 6046A	The filing of Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, for those taxpayers who do not have to file an income tax return. The form is due at the time that an income tax return would have been due had the taxpayer been required to file an income tax return or at the time any required information return is due.
50. Secs. 6039F and 6048	Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, must be filed by the due date of the U.S. person's income tax return, including extensions.
51. Sec. 6662(e) and Treas. Reg. § 1.6662–6(d)(2)(iii)(A)	A taxpayer must provide, within 30 days of a request by the IRS, specified "principal documents" regarding the taxpayer's selection and application of transfer pricing method to avoid potential penalties in the event of a final transfer pricing adjustment by the IRS. See also Treas. Reg. § 1.6662–6(d)(2)(iii)(C) (similar requirement re: background documents).

SECTION 13. PARTNERSHIP AND S CORPORATION ISSUES

Statute or Regulation	Act Postponed
1. Treas. Reg. §§ 1.442–1(b)(1) and (3) and 1.706–1(b)(8)	A partnership may obtain approval of the Commissioner to adopt, change or retain an annual accounting period by filing Form 1128, *Application To Adopt, Change, or Retain a Tax Year*, within such time as provided in administrative procedures published by the Commissioner. See Rev. Procs. 2006–46, 2006–45 I.R.B. 859, and 2002–39, 2002–1 C.B. 1046.
2. Treas. Reg. § 1.743–1(k)(2)	A transferee that acquires, by sale or exchange, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within 30 days of the sale or exchange. A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner.
3. Treas. Reg. § 1.754–1(c)(1)	Generally, a partnership may revoke a section 754 election by filing the revocation no later than 30 days after the close of the partnership taxable year with respect to which the revocation is intended to take effect.
4. Treas. Reg. § 1.761–2(b)(3)	A partnership may generally elect to be excluded from subchapter K. The election will be effective unless within 90 days after the formation of the organization any member of the organization notifies the Commissioner that the member desires subchapter K to apply to such organization and also advises the Commissioner that he has so notified all other members of the organization. In addition, an application to revoke an election to be excluded from subchapter K must be submitted no later than 30 days after the beginning of the first taxable year to which the revocation is to apply.
5. Treas. Reg. § 1.761–2(c)	A partnership requesting permission to be excluded from certain provisions of subchapter K must submit the request to the Commissioner no later than 90 days after the beginning of the first taxable year for which partial exclusion is desired.

Statute or Regulation	Act Postponed
6. Sec. 1361(e)	In general, the trustee of the electing small business trust (ESBT) must file the ESBT election within the 2-month and 16-day period beginning on the day the stock is transferred to the trust. See Treas. Reg. § 1.1361–1(m)(2)(ii).
7. Treas. Reg. § 1.1361–1(j)(6)	The current income beneficiary of a qualified subchapter S trust (QSST) must make a QSST election within the 2-month and 16-day period from one of the dates prescribed in section 1.1361–1(j)(6)(iii).
8. Treas. Reg. § 1.1361–1(j)(10)	The successive income beneficiary of a QSST may affirmatively refuse to consent to the QSST election. The beneficiary must sign the statement and file the statement with the IRS within 15 days and 2 months after the date on which the successive income beneficiary becomes the income beneficiary.
9. Treas. Reg. § 1.1361–3(a)(4)	If an S corporation elects to treat an eligible subsidiary as a qualified subchapter S subsidiary (QSUB), the election cannot be effective more than 2 months and 15 days prior to the date of filing the election.
10. Treas. Reg. § 1.1361–3(b)(2)	An S corporation may revoke a QSUB election by filing a statement with the service center. The effective date of a revocation of a QSUB election cannot be more than 2 months and 15 days prior to the filing date of the revocation.
11. Treas. Reg. § 1.1362–2(a)(2), (4)	If a corporation revokes its subchapter S election after the first $2^1/_2$-months of its taxable year, the revocation will not be effective until the following taxable year. An S corporation may rescind a revocation of an S election at any time before the revocation becomes effective.
12. Sec. 1362(b)(1)	An election under section 1362(a) to be an S corporation may be made by a small business corporation for any taxable year at any time during the preceding taxable year, or at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year.
13. Rev. Proc. 2003–43	This revenue procedure provides a simplified method for taxpayers requesting relief for late S corporation elections, Qualified Subchapter S Subsidiary (QSUB) elections, Qualified Subchapter S Trust (QSST) elections, and Electing Small Business Trust (ESBT) elections. Generally, this revenue procedure provides that certain eligible entities may file late elections within 24 months of the due date of the election.
14. Rev. Proc. 2004–48	This revenue procedure provides a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election which was intended to be effective on the same date that the S corporation election was intended to be effective. This revenue procedure provides that within 6 months after the due date for the tax return, excluding extensions, for the first year the entity intended to be an S corporation, the corporation must file a properly completed Form 2553, *Election by a Small Business Corporation*, with the applicable service center.
15. Sec. 1378(b) and Treas. Reg. § 1.1378–1(c)	An S or electing S corporation may obtain the approval of the Commissioner to adopt, change or retain an annual accounting period by filing Form 1128, *Application To Adopt, Change, or Retain a Tax Year*, within such time as is provided in administrative procedures published by the Commissioner. See Rev. Procs. 2006–46 and 2002–39.

SECTION 14. PROCEDURE & ADMINISTRATION ISSUES

.01 Bankruptcy and Collection

Statute or Regulation	Act Postponed
1. Treas. Reg. § 301.6036–1(a)(2) and (3)	A court-appointed receiver or fiduciary in a non-bankruptcy receivership, a fiduciary in aid of foreclosure who takes possession of substantially all of the debtor's assets, or an assignee for benefit of creditors, must give written notice within ten days of his appointment to the IRS as to where the debtor will file his tax return.
2. Sec. 6320(a)(3)(B) and (c) and Treas. Reg. § 301.6320–1(b), (c) and (f)	A taxpayer has 30 days after receiving a notice of a lien to request a Collection Due Process (CDP) administrative hearing. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court.

Statute or Regulation	Act Postponed
3. Sec. 6330(a)(3)(B) and (d)(1) and Treas. Reg. § 301.6330–1(b), (c) and (f)	The taxpayer must request a Collections Due Process (CDP) administrative hearing within 30 days after the IRS sends notice of a proposed levy. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court.
4. Sec. 6331(k)(1) and Treas. Reg. § 301.7122–1(g)(2)	If a taxpayer submits a good-faith revision of a rejected offer in compromise within 30 days after the rejection, the Service will not levy to collect the liability before deciding whether to accept the revised offer.
5. Sec. 6331(k)(2) and Treas. Reg. § 301.6331–4(a)(1)	If, within 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, no levy may be made while the rejection or termination is being considered by Appeals.
6. Rev. Proc. 2005–34, Sec. 4.01	If the Service determines that a taxpayer is liable for the trust fund recovery penalty under section 6672, the Service will provide the taxpayer an opportunity to dispute the proposed assessment by appealing the proposed assessment within 60 days of the date on the notice (75 days if the notice is addressed to the taxpayer outside of the United States).
7. Sec. 7122(d)(2) and Treas. Reg. § 301.7122–1(f)(5)(i)	A taxpayer must request administrative review of a rejected offer in compromise within 30 days after the date on the letter of rejection.

.02 Information Returns

Statute or Regulation	Act Postponed
1. Sec. 6050I	Any person engaged in a trade or business receiving more than $10,000 cash in one transaction (or 2 or more related transactions) must file an information return, Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business*, by the 15th day after the date the cash was received. Additionally, a statement must be provided to the person with respect to whom the information is required to be furnished by Jan. 31st of the year following.
2. Sec. 6050K and Treas. Reg. 1.6050K–1(f)(2)	A partnership notified of an exchange after the partnership has filed its Form 1065 for the taxable year with respect to which the exchange should have been reported shall file its Form 8308 with the service center where its Form 1065 was filed on or before the 30th day after the partnership is notified of the exchange.
3. Sec. 6050L	Returns relating to certain dispositions of donated property, Forms 8282, *Donee Information Return*, must be filed within 125 days of the disposition.

.03 Miscellaneous

Statute or Regulation	Act Postponed
1. Sec. 1314(b)	A taxpayer may file a claim for refund or credit of tax based upon the mitigation provisions of sections 1311 through 1314 if, as of the date a determination (as defined in section 1313(a)) is made, one year remains on the period for filing a claim for refund.
2. Sec. 6015	A requesting spouse must request relief under section 6015 within 2 years of the first collection activity against the requesting spouse.
3. Sec. 6015(e)	A requesting spouse may petition the Tax Court to determine the appropriate relief under this section if such petition is filed not later than the close of the 90th day after the Service mails, by certified or registered mail, notice of the Service's final determination of relief available to the individual.

Statute or Regulation	Act Postponed
4. Sec. 6411	Taxpayers applying for a tentative carryback adjustment of the tax for the prior taxable year must file Form 1139, *Corporation Application for Tentative Refund*, (for corporations) or Form 1045, *Application for Tentative Refund*, (for entities other than corporations) within 12 months after the end of such taxable year that generates such net operating loss, net capital loss, or unused business credit from which the carryback results.
5. Sec. 6656(e)(2)	A taxpayer who is required to deposit taxes and fails to do so is subject to a penalty under section 6656. Under section 6656(e)(2), the taxpayer may, within 90 days of the date of the penalty notice, designate to which deposit period within a specified tax period the deposits should be applied.

SECTION 15. TAX CREDIT ISSUES

Statute or Regulation	Act Postponed
1. Sec. 42(e)(3)(A)(ii)	A taxpayer has a 24-month measuring period in which the requisite amount of rehabilitation expenditures has to be incurred in order to qualify for treatment as a separate new building.
2. Treas. Reg. § 1.42–5(c)(1)	The taxpayer must make certain certifications at least annually to the Agency.
3. Treas. Reg. § 1.42–5(c)(1)(iii)	The taxpayer must receive an annual income certification from each low-income tenant with documentation to support the certification.
4. Treas. Reg. § 1.42–8(a)(3)(v)	The taxpayer and an Agency may elect to use an appropriate percentage under section 42(b)(2)(A)(ii)(I) by notarizing a binding agreement by the 5th day following the end of the month in which the binding agreement was made.
5. Treas. Reg. § 1.42–8(b)(1)(vii)	The taxpayer and an Agency may elect an appropriate percentage under section 42(b)(2)(A)(ii)(II) by notarizing a binding agreement by the 5th day following the end of the month in which the tax-exempt bonds are issued.
6. Sec. 42(d)(2)(D)(ii)(IV)	In order to claim section 42 credits on an existing building, section 42(d)(2)(B)(ii)(I) requires that the building must have been placed in service at least ten years before the date the building was acquired by the taxpayer. A building is not considered placed in service for purposes of section 42(d)(2)(B)(ii) if the building is resold within a 12-month period after acquisition by foreclosure of any purchase-money security interest.
7. Sec. 42(g)(3)(A)	A building shall be treated as a qualified low-income building only if the project meets the minimum set aside requirement by the close of the first year of the credit period of the building.
8. Sec. 42(h)(6)(J)	A low-income housing agreement commitment must be in effect as of the beginning of the year for a building to receive credit. If such a commitment was not in effect, the taxpayer has a one-year period for correcting the failure.
9. Sec. 42(h)(1)(E) and (F)	The taxpayer's basis in the building project, as of the later of the date which is 6 months after the date the allocation was made or the close of the calendar year in which the allocation is made, must be more than 10 percent of the taxpayer's reasonably expected basis in the project.
10. Sec. 47(c)(1)(C) and Treas. Reg. § 1.48–12(b)(2)	A taxpayer has a 24- or 60-month measuring period in which the requisite amount of rehabilitation expenditures have to be incurred in order to satisfy the "substantial rehabilitation" test.
11. Treas. Reg. § 1.48–12(d)(7)	In the historic rehabilitation context, if the taxpayer fails to receive final certification of completed work prior to the date that is 30 months after the date that the taxpayer filed the return on which the credit is claimed, the taxpayer must, prior to the last day of the 30th month, consent to extending the statute of limitations by submitting a written statement to the Service.
12. Sec. 51(d)(12)(A)(ii)(II) and 51A(d)(1)	An employer seeking the Work Opportunity Credit with respect to an individual must submit Form 8850, *Pre-Screening Notice and Certification Request for the Work Opportunity Credit*, to the State Employment Security Agency (State Workforce Agency) not later than the 28th day after the individual begins work for the employer.

SECTION 16. TAX-EXEMPT BOND ISSUES

Statute or Regulation	Act Postponed
1. Treas. Reg. § 1.25–4T(c)	On or before the date of distribution of mortgage credit certificates under a program or December 31, 1987, the issuer must file an election not to issue an amount of qualified mortgage bonds. An election may be revoked, in whole or on part, at any time during the calendar year in which the election was made.
2. Treas. Reg. §§ 1.141–12(d)(3) and 1.142–2(c)(2)	An issuer must provide notice to the Commissioner of the establishment of a defeasance escrow within 90 days of the date such defeasance escrow is established in accordance with sections 1.141–12(d)(1) or 1.142–2(c)(1).
3. Sec. 142(d)(7)	An operator of a multi-family housing project for which an election was made under section 142(d) must submit to the Secretary an annual certification as to whether such project continues to meet the requirements of section 142(d).
4. Sec. 142(f)(4) and Treas. Reg. § 1.142(f)(4)–1	A person engaged in the local furnishing of electric energy or gas (a local furnisher) that uses facilities financed with exempt facility bonds under section 142(a)(8) and expands its service area in a manner inconsistent with the requirements of sections 142(a)(8) and 142(f), may make an election to ensure that those bonds will continue to be treated as exempt facility bonds. The election must be filed with the IRS on or before 90 days after the date of the service area expansion that causes the bonds to cease to meet the applicable requirements.
5. Sec. 146(f) and Notice 89–12	If an issuing authority's volume cap for any calendar year exceeds the aggregate amount of tax-exempt private activity bonds issued during such calendar year by such authority, such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward purposes. Such election must be filed by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises, or (2) the date of issue of bonds issued pursuant to the carryforward election.
6. Sec. 148(f)(3) and Treas. Reg. § 1.148–3(g)	An issuer of a tax-exempt municipal obligation must make any required rebate payment no later than 60 days after the computation date to which the payment relates. A rebate payment is paid when it is filed with the IRS at the place or places designated by the Commissioner. A payment must be accompanied by the form provided by the Commissioner for this purpose.
7. Treas. Reg. § 1.148–5(c)	An issuer of a tax-exempt municipal obligation must make a yield reduction payment on or before the date of required rebate installment payments as described in section 1.148–3(f), (g), and (h).
8. Sec. 148(f)(4)(C)(xvi) and Treas. Reg. § 1.148–7(k)(1)	As issuer of a tax-exempt municipal obligation that elects to pay certain penalties in lieu of rebate must make any required penalty payments not later than 90 days after the period to which the penalty relates.
9. Sec. 149(e)	An issuer of a tax-exempt municipal obligation must submit to the Secretary a statement providing certain information regarding the municipal obligation not later than the 15th day of the 2nd calendar month after the close of the calendar quarter in which the municipal obligation is issued.

SECTION 17. SPECIAL RULES FOR SECTION 1031 LIKE-KIND EXCHANGE TRANSACTIONS

.01 Taxpayers are provided the relief described in this section if an IRS news release or other guidance provides relief for acts listed in this revenue procedure (unless the news release or other guidance specifies otherwise).

.02 (1) The last day of a 45-day identification period set forth in section 1.1031(k)–1(b)(2) of the Income Tax Regulations, the last day of a 180-day exchange period set forth in section 1.1031(k)–1(b)(2), and the last day of a period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, that fall on or after the date of a Presidentially declared disaster, are postponed by 120 days or to the last day of the general disaster extension period authorized by an IRS News Release or other guidance announcing tax relief for victims of the specific Presidentially declared disaster, whichever is later. However, in no event may a postponement period extend beyond: (a) the due date (including extensions) of the taxpayer's tax return for the year of the transfer (See Treas. Reg. § 1.1031(k)–1(b)(2)); or (b) one year (See IRC § 7508A(a)).

(2) A taxpayer who is a transferor qualifies for a postponement under this section only if—

(a) The relinquished property was transferred on or before the date of the Presidentially declared disaster, or in a transaction governed by Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, qualified *indicia* of ownership were transferred to the

exchange accommodation titleholder on or before that date; and

(b) The taxpayer (transferor)—

(i) Is an "affected taxpayer" as defined in the IRS News Release or other guidance announcing tax relief for the victims of the specific Presidentially declared disaster; or

(ii) Has difficulty meeting the 45-day identification or 180-day exchange deadline set forth in section 1.1031(k)–1(b)(2), or a deadline set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, due to the Presidentially declared disaster for the following or similar reasons:

(A) The relinquished property or the replacement property is located in a covered disaster area (as defined in section 301.7508A–1(d)(2)) as provided in the IRS News Release or other guidance (the covered disaster area);

(B) The principal place of business of any party to the transaction (for example, a qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution, or a title insurance company) is located in the covered disaster area;

(C) Any party to the transaction (or an employee of such a party who is involved in the section 1031 transaction) is killed, injured, or missing as a result of the Presidentially declared disaster;

(D) A document prepared in connection with the exchange (for example, the agreement between the transferor and the qualified intermediary or the deed to the relinquished property or replacement property) or a relevant land record is destroyed, damaged, or lost as a result of the Presidentially declared disaster;

(E) A lender decides not to fund either permanently or temporarily a real estate closing due to the Presidentially declared disaster or refuses to fund a loan to the taxpayer because flood, disaster, or other hazard insurance is not available due to the Presidentially declared disaster; or

(F) A title insurance company is not able to provide the required title insurance policy necessary to settle or close a real estate transaction due to the Presidentially declared disaster.

.03 The postponement described in this section also applies to the last day of a 45-day identification period described in section 1.1031(k)–1(b)(2) and the last day of a 45-day identification period described in section 4.05(4) of Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51, that falls prior to the date of a Presidentially declared disaster if an identified replacement property (in the case of an exchange described in section 1.1031(k)–1), or an identified relinquished property (in the case of an exchange described in Rev. Proc. 2000–37, modified by Rev. Proc. 2004–51) is substantially damaged by the Presidentially declared disaster.

.04 If the taxpayer (transferor) qualifies for relief under this section for any reason other than section 17.02(2)(b)(i), then such taxpayer is not considered an affected taxpayer for purposes of any other act listed in this revenue procedure or for any acts listed in an IRS News Release or other published guidance related to the specific Presidentially declared disaster.

SECTION 18. INQUIRIES

If you wish to recommend that other acts qualify for postponement, please write to the Office of Associate Chief Counsel, Procedure and Administration CC:PA:B7, 1111 Constitution Avenue, NW, Washington, DC 20224. Please mark "7508A List" on the envelope. In the alternative, e-mail your comments to: *Notice.Comments@irscounsel.treas.gov*, and refer to Rev. Proc. 2005–27 in the Subject heading.

SECTION 19. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 2005–27, 2005–1 C.B. 1050, is superseded.

SECTION 20. EFFECTIVE DATE

This revenue procedure is effective for acts that may be performed or disasters which occur on or after August 20, 2007.

SECTION 21. DRAFTING INFORMATION

The principal author of this revenue procedure is Melissa Quale in Branch 7, of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding section 1031 like-kind exchange postponements under section 17 of this revenue procedure, contact Peter J. Baumgarten or Michael F. Schmit of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622–4920 (not a toll-free call) or (202) 622–4960 (not a toll-free call), respectively. For further information regarding other sections of this revenue procedure, contact Ms. Quale at (202) 622–4570 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Application of Section 6404(g) of the Internal Revenue Code Suspension Provisions

REG–149036–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document proposes regulations for the suspension of interest, penalties, additions to tax, or additional amounts under section 6404(g) of the Internal Revenue Code (Code) that explain the general rules for suspension as well as exceptions to those general rules. The proposed regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998, the American Jobs Creation Act of 2004, the Gulf Opportunity Zone Act of 2005, the Tax Relief and Health Care Act of 2006, and the Small Business Work Opportunity Tax Act of 2007. The proposed regulations affect individual taxpayers who file timely income tax returns with respect to whom the IRS does not timely provide a notice specifically stating an additional tax liability and the basis for that liability. This document also provides a notice of public hearing on the proposed regulations.

DATES: Written or electronic comments must be received by September 19, 2007. Outlines of topics to be discussed at the public hearing scheduled for October 11, 2007, at 10 a.m. must be received by September 20, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–149036–04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149036–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–149036–04). The public hearing will be held in the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stuart Spielman, (202) 622–7950; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622–7180 (not toll-free numbers) or *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background

This document amends the Procedure and Administration Regulations (26 CFR part 301) by adding rules relating to the suspension of interest, penalties, additions to tax, or additional amounts under section 6404(g). Section 6404(g) was added to the Code by section 3305 of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 685, 743) (RRA 98), effective for taxable years ending after July 22, 1998. Section 6404(g) was amended by section 903(c) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418, 1652) (AJCA), enacted on October 22, 2004; by section 303 of the Gulf Opportunity Zone Act of 2005, Public Law 109–135 (119 Stat. 2577, 2608–09) (GOZA), enacted on December 21, 2005; by section 426(b) of the Tax Relief and Health Care Act of 2006, Public Law 109–432 (120 Stat. 2922, 2975), enacted on December 20, 2006; and by section 8242 of the Small Business and Work Opportunity Tax Act of 2007, Public Law 110–28 (121 Stat. 190, 200), enacted on May 25, 2007. The Treasury Department and the Internal Revenue Service are aware that questions have been raised regarding the effective date of the changes made by the Small Business and Work Opportunity Act of 2007 and are considering further guidance. These regulations are prescribed under section 7805.

Explanation of Provisions

General Rule

If an individual taxpayer files a Federal income tax return on or before the due date for that return (including extensions), and if the IRS does not timely provide a notice to that taxpayer specifically stating the taxpayer's liability and the basis for that liability, then the IRS must suspend any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return that is computed by reference to the period of time the failure continues and that is properly allocable to the suspension period. A notice is timely if provided before the close of the eighteen-month period (thirty-six month period, in the case of notices provided after November 25, 2007) beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions. The suspension period begins on the day after the close of the eighteen-month period (or thirty-six month period) and ends twenty-one days after the IRS provides the notice. This suspension rule applies separately with respect to each item or adjustment.

Amended Returns

The proposed regulations provide guidance on applying section 6404(g) to amended returns and other signed documents that show an increased tax liability, as well as to amended returns that show a decreased tax liability. If, on or after December 21, 2005, a taxpayer provides to the IRS an amended return or other signed written document showing an additional tax liability, then the eighteen-month period (or thirty-six month period) does not begin to run with respect to the items that gave rise to the additional tax liability until that return or other signed written document is provided to the IRS. This rule is mandated by GOZA section 303(b). Except as provided in GOZA section 303(b), the filing of an amended return has no effect on the running of the eighteen-month period (or thirty-six month period) under

section 6404(g). Accordingly, if a taxpayer files an amended return or other signed written document showing a decrease in tax liability and the IRS at any time proposes to adjust the changed item or items, any interest, penalty, addition to tax, or additional amount with respect to the changed item or items on the amended return or other signed written document will not be suspended. If married taxpayers file a return claiming a change in filing status to married filing jointly, the general rule authorizing suspension will not apply unless each spouse's separate return, if required to be filed, was timely. An amended return or other written document is provided to the IRS for purposes of these proposed regulations when it is received by the IRS.

Notice of Liability and the Basis for Liability

Notice to the taxpayer must be in writing and specifically state the amount of the liability and the basis for the liability. The notice must provide the taxpayer with sufficient information to identify which items of income, deduction, loss, or credit the IRS has adjusted or proposes to adjust, and the reason for that adjustment. Administrative proceedings pertaining to adjustments to partnership items of partnerships subject to the unified audit and litigation procedures of Subchapter C of Chapter 63 of Subtitle F of the Internal Revenue Code (TEFRA) occur at the partnership level. Each partner has the right to participate in partnership-level administrative proceedings. The tax matters partner (TMP) of a TEFRA partnership has a fiduciary relationship to the partners and must provide the partners with information concerning significant administrative proceedings and actions within 30 days of the action or the receipt of information concerning the partnership matter. TEFRA partnership administrative proceedings at the partnership level concern the treatment of partnership items and the partners' allocable shares of those items rather than the specific tax liability of each partner attributable to the partnership items. Partners can, however, compute the specific tax attributable to adjustments to partnership items based on their interests in the partnership, so notice to the TMP concerning the treatment of partnership items constitutes notice to the partners under section 6404(g).

Exceptions to the General Rule for Suspension

The general rule for suspension does not apply to (1) any penalty imposed by section 6651 for failing to file a tax return or for failing to pay tax; (2) any interest, penalty, addition to tax, or additional amount in a case involving fraud; (3) any interest, penalty, addition to tax, or additional amount with respect to any tax liability shown on a return; (4) any interest, penalty, addition to tax, or additional amount with respect to any gross misstatement; (5) any interest, penalty, addition to tax, or additional amount with respect to any reportable transaction not meeting the disclosure requirement of section 6664(d)(2)(A) or any listed transaction as defined in section 6707A(c); and (6) any criminal penalty.

The proposed regulations limit the exception pertaining to a case involving fraud to the taxpayer and the taxable year in issue. The proposed regulations also provide that the exception in section 6404(g) for "a case involving fraud" means that fraud on the return with respect to any item will preclude suspension under section 6404(g) with respect to all items on the return.

AJCA section 903(b) added subparagraph (D), pertaining to gross misstatements, to section 6404(g)(2), effective for taxable years beginning after December 31, 2003. The proposed regulations define "gross misstatement" as the reporting of any item on the original or any amended return if that item is attributable to a gross valuation misstatement as defined in section 6662(h), a substantial omission of income as described in section 6501(e)(1) or section 6229(c), or a frivolous position or a desire to delay or impede the administration of the Federal income tax laws as described in section 6702.

Special Rules

Section 6404(g)(2)(C) provides that interest suspension does not apply to any tax liability shown on a return. Consistent with this exception, any interest, penalty, addition to tax, or additional amount with respect to an erroneous tentative carryback or refund adjustment will not be suspended because the disallowance of the erroneous tentative carryback or refund adjustment does not change the tax liability originally shown on the taxpayer's return. An election under section 183(e) to defer the determination as to whether the presumption applies that an activity is engaged in for profit tolls the notification period and the suspension period described in section 6404(g)(1), in that the election calls for the IRS to defer proposing adjustments regarding the activity.

Proposed Effective Date

The regulations, as proposed, apply as of the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for October 11, 2007, beginning at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security

procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments on September 19, 2007, and an outline of the topics to be discussed, and the time to be devoted to each topic (signed original and eight (8) copies) by September 20, 2007. A period of ten minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Stuart Spielman of the Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly 26 CFR part 301 is proposed to be amended as follows:

PART 301 PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6404–0 is amended as follows:

1. The introductory text is revised.

2. Entries are added for §301.6404–4.

The addition reads as follows:

§301.6404–0 Table of contents.

This section lists the paragraphs contained in §§301.6404–1 through 301.6404–4.

* * * * *

§301.6404–4 Suspension of interest and certain penalties where the Internal Revenue Service does not contact the taxpayer.

(a) Suspension.

(1) In general.

(2) Treatment of amended returns and other documents.

(i) Amended returns filed on or after December 21, 2005, that shows an increase in tax liability.

(ii) Amended returns that show a decrease in tax liability.

(iii) Amended return and other documents as notice.

(iv) Joint return after filing separate return.

(3) Separate application.

(4) Duration of suspension period.

(5) Example.

(6) Notice of liability and the basis for the liability.

(i) In general.

(ii) Tax attributable to TEFRA partnership items.

(iii) Examples.

(7) Providing notice by the IRS.

(i) In general.

(ii) Providing notice in TEFRA partnership proceedings.

(b) Exceptions.

(1) Failure to file tax return or to pay tax.

(2) Fraud.

(3) Tax shown on return.

(4) Gross misstatement.

(i) Description.

(5) [Reserved].

(c) Special rules.

(1) Tentative carryback and refund adjustments.

(2) Election under section 183(e).

(d) Effective/applicability date.

Par. 3. Section 301.6404–4 is added to read as follows:

§301.6404–4 Suspension of interest and certain penalties where the Internal Revenue Service does not contact the taxpayer.

(a) *Suspension*—(1) *In general*. Except as provided in paragraph (b) of this section, if an individual taxpayer files a return of tax imposed by subtitle A on or before the due date for the return (including extensions) and the Internal Revenue Service (IRS) does not timely provide the taxpayer with a notice specifically stating the amount of any increased liability and the basis for that liability, then the IRS must suspend any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return. This suspension is computed by reference to the period of time the failure continues to exist. The notice described in this paragraph (a)(1) is timely if provided before the close of the eighteen-month period (thirty-six month period in the case of notices provided after November 25, 2007) beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions.

(2) *Treatment of amended returns and other documents*—(i) *Amended returns filed on or after December 21, 2005, that show an increase in tax liability*. If a taxpayer, on or after December 21, 2005, provides to the IRS an amended return or one or more other signed written documents showing an increase in tax liability, the date on which the return was filed will, for purposes of this paragraph (a), be the date on which the last of the documents was provided. Documents described in this paragraph (a)(2)(i) are provided on the date that they are received by the IRS.

(ii) *Amended returns that show a decrease in tax liability*. If a taxpayer provides to the IRS an amended return or other signed written document that shows a decrease in tax liability, any interest, penalty, addition to tax, or additional amount will not be suspended if the IRS at any time proposes to adjust the changed item or items on the amended return or other signed written document.

(iii) *Amended return and other documents as notice*. As to the items reported, an amended return or one or more other signed written documents showing that the taxpayer owes an additional amount of tax for the taxable year serves as the notice described in paragraph (a)(1) of this section.

(iv) *Joint return after filing separate return.* A joint return filed under section 6013(b) is subject to the rules for amended returns described in this paragraph (a)(2). The IRS will not suspend any interest, penalty, addition to tax, or additional amount on a joint return filed under section 6013(b) unless each spouse, if required to file a return, filed a timely separate return.

(3) *Separate application.* This paragraph (a) shall be applied separately with respect to each item or adjustment.

(4) *Duration of suspension period.* The suspension period described in paragraph (a)(1) of this section begins the day after the close of the eighteen-month period (thirty-six month period, in the case of notices provided after November 25, 2007) beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions. The suspension period ends twenty-one days after the earlier of the date on which the IRS mails the required notice to the taxpayer's last known address, the date on which the required notice is hand-delivered to the taxpayer, or the date on which the IRS receives an amended return or other signed written document showing an increased liability.

(5) *Example.* The following example illustrates the rules of this paragraph (a):

Example. An individual taxpayer timely files an income tax return for taxable year 2004 on the due date of the return, April 15, 2005. On December 11, 2006, the taxpayer mails to the IRS an amended return reporting an additional item of income and an increased tax liability for taxable year 2004. The IRS receives the amended return on December 13, 2006. On January 16, 2007, the IRS provides the taxpayer with a notice stating that the taxpayer has an additional tax liability based on the disallowance of a deduction the taxpayer claimed on his original return and did not change on his amended return. The date the amended return was received substitutes for the date that the original return was filed with respect to the additional item of tax liability reported on the amended return. Thus, the IRS will not suspend interest, penalties, additions to tax, or additional amounts with respect to the additional item of income and the increased tax liability reported on the amended return. The suspension period for the additional tax liability based on the IRS' disallowance of the deduction begins on October 15, 2006, so the IRS will suspend interest, penalties, additions to tax, and additional amounts with respect to the disallowed deduction and additional tax liability from that date through February 6, 2007, which is twenty-one days after the IRS provided notice of the additional tax liability and the basis for that liability.

(6) *Notice of liability and the basis for the liability*—(i) *In general.* Notice to the taxpayer must be in writing and specifically state the amount of the liability and the basis for the liability. The notice must provide the taxpayer with sufficient information to identify which items of income, deduction, loss, or credit the IRS has adjusted or proposes to adjust, and the reason for that adjustment. Notice of the reason for the adjustment does not require a detailed explanation or a citation to any Internal Revenue Code section or other legal authority. The IRS does not have to incorporate all the information necessary to satisfy the notice requirement within a single document or provide all the information at the same time. Documents that may contain information sufficient to qualify as notice, either alone or in conjunction with other documents, include, but are not limited to, statutory notices of deficiency, examination reports (for example, Forms 4549 "*Income Tax Examination Changes*," Forms 886–A "*Explanation of Items*"), Forms 870 "*Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*," notices of proposed deficiency that allow the taxpayer an opportunity for review in the Office of Appeals (30-day letters), notices pursuant to section 6213(b) (mathematical or clerical errors), and notice and demand for payment of a jeopardy assessment under section 6861.

(ii) *Tax attributable to TEFRA partnership items.* Notice to the partner or the tax matters partner (TMP) of a partnership subject to the Unified Audit and Litigation Procedures of subchapter C of chapter 63 of subtitle F of the Internal Revenue Code (TEFRA) that provides specific information about the basis for the adjustments to partnership items is sufficient notice if a partner could reasonably compute the specific tax attributable to the partnership item based on the proposed adjustments as applied to the partner's individual tax situation. Documents provided by the IRS during a TEFRA partnership proceeding that may contain information sufficient to satisfy the notice requirements include, but are not limited to, a Notice of Final Partnership Administrative Adjustment, examination reports (for example, Forms 4549, Forms 886–A), or a letter that allows the partners an opportunity for review in the Office of Appeals (60-day letter).

(iii) *Examples.* The following examples illustrate the rules of this paragraph (a)(6).

Example 1. During an audit of Taxpayer A's 2005 taxable year return, the IRS questions a charitable deduction claimed on the return. The IRS provides A with a "30-day letter" that proposes a deficiency of $1,000 based on the disallowance of the charitable deduction and informs A that A may file a written protest of the proposed deficiency to the Office of Appeals within 30 days. The letter includes as an attachment a copy of the revenue agent's report that states that "It has not been established that the amount shown on your return as a charitable contribution was paid during the tax year. Therefore, this deduction is not allowable." The information in the 30-day letter and attachment provides A with notice of the specific amount of the liability and the basis for that liability as described in this paragraph (a).

Example 2. Taxpayer B is a partner in partnership P, a TEFRA partnership for taxable year 2005. B claims a distributive share of partnership income on B's Federal income tax return for 2005 filed on April 17, 2006. On October 1, 2007, during the course of a partnership audit of P for taxable year 2005, the IRS provides P's TMP a "60-day letter" proposing to adjust P's income by $10,000. The IRS had previously provided the TMP with a copy of the examination report explaining that the adjustment was based on $10,000 of unreported net income. On October 31, 2007, P's TMP informs B of the proposed adjustment as required by §301.6223(g)–1(b). By accounting for B's distributive share of the $10,000 of unreported income from P with B's other income tax items, B can determine B's tax attributable to the $10,000 partnership adjustment. The information in the 60-day letter and the examination report allows B to compute the specific amount of the liability attributable to the adjustment to the partnership item and the basis for that adjustment and therefore satisfies the notice requirement of paragraph (a). Because the IRS provided that notice to the TMP, B's agent under the TEFRA partnership provisions, within eighteen months of the April 17, 2006, filing date of B's return, any interest, penalty, addition to tax, or additional amount with respect to B's tax liability attributable to B's distributive share of the $10,000 of unreported partnership income will not be suspended under section 6404(g).

(7) *Providing notice by the IRS*—(i) *In general.* The IRS may provide notice by mail or in person to the taxpayer or the taxpayer's representative. If the IRS mails the notice, it must be sent to the taxpayer's last known address under rules similar to section 6212(b), except that certified or registered mail is not required. Notice is considered provided as of the date of mailing or delivery in person.

(ii) *Providing notice in TEFRA partnership proceedings.* In the case of TEFRA partnership proceedings, the IRS must provide notice of final partnership administrative adjustments (FPAA) by mail to those partners specified in section 6223. Within 60 days of an FPAA being mailed, the TMP is required to forward notice of

the FPAA to those partners not entitled to direct notice from the IRS under section 6223. Certain partners with small interests in partnerships with more than 100 partners may form a Notice Group and designate a partner to receive the FPAA on their behalf. The IRS may provide other information after the beginning of the partnership administrative proceeding to the TMP who, in turn, must provide that information to the partners specified in §301.6223(g)–1 within 30 days of receipt. Pass-thru partners who receive notices and other information from the IRS or the TMP must forward that notice or information within 30 days to those holding an interest through the pass-thru partner. Information provided by the IRS to the TMP is deemed to be notice for purposes of this section to those partners specified in §301.6223(g)–1 as of the date the IRS provides that notice to the TMP. A similar rule applies to notice provided to the designated partner of a Notice Group, and to notice provided to a pass-thru partner. In the foregoing situations, the TMP, designated partner, and pass-thru partner are agents for direct and indirect partners. Consequently, notice to these agents is deemed to be notice to the partners for whom they act.

(b) *Exceptions*—(1) *Failure to file tax return or to pay tax*. Paragraph (a) of this section does not apply and interest will not be suspended with respect to any penalty imposed by section 6651.

(2) *Fraud*. Paragraph (a) of this section does not apply and interest will not be suspended with respect to any interest, penalty, addition to tax, or additional amount in a case involving fraud. Fraud has the same meaning in this paragraph (b) as in section 6501(c)(1) and is not attributed from one taxpayer to another taxpayer. If a taxpayer files a fraudulent return for one year, paragraph (a) of this section may apply to any other tax year of the taxpayer that does not involve fraud. Fraud affecting one item on a return precludes paragraph (a) of this section from applying to any other items on that return.

(3) *Tax shown on return*. Paragraph (a) of this section does not apply and interest will not be suspended with respect to any interest, penalty, addition to tax, or additional amount with respect to any tax liability shown on a return.

(4) *Gross misstatement*—(i) *Description*. Paragraph (a) of this section does not apply and interest will not be suspended with respect to any interest, penalty, addition to tax, or additional amount with respect to a gross misstatement. A *gross misstatement* for purposes of this paragraph (b) means—

(A) A substantial omission of income as described in section 6501(e)(1) or section 6229(c)(2);

(B) A gross valuation misstatement within the meaning of section 6662(h); or

(C) A misstatement to which the penalty under section 6702(a) applies.

(ii) If a gross misstatement occurs, then interest will not be suspended with respect to any items of income omitted from the return and with respect to overstated deductions, even though one or more of the omitted items would not constitute a substantial omission, gross valuation misstatement, or misstatement to which section 6702(a) applies.

(5) [Reserved].

(c) *Special rules*—(1) *Tentative carryback and refund adjustments*. If an amount applied, credited, or refunded under section 6411 exceeds the overassessment properly attributable to a tentative carryback or refund adjustment, any interest, penalty, addition to tax, or additional amount with respect to the excess will not be suspended.

(2) *Election under section 183(e)*. If a taxpayer elects under section 183(e) to defer the determination as to whether the presumption applies that an activity is engaged in for profit, the 18-month (or 36-month) notification period described in paragraph (a)(1) of this section or, if that period has passed as of the date the election is made, the suspension period described in paragraph (a)(4) of this section will be tolled for the period to which the election applies. Tolling will begin on the date the election is made and end on the later of the date the return for the last taxable year to which the election applies is filed or is due without regard to extensions.

(d) *Effective/applicability date*. The rules of this section apply as of the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 21, 2007, 72 F.R. 34199)

Notice of Proposed Rulemaking by Reference to Temporary Regulations and Notice of Proposed Rulemaking

Excise Taxes on Prohibited Tax Shelter Transactions and Related Disclosure Requirements; Disclosure Requirements With Respect to Prohibited Tax Shelter Transactions; Requirement of Return and Time for Filing

REG–142039–06; REG–139268–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by reference to temporary regulations and notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance under section 4965 of the Internal Revenue Code (Code), relating to entity-level and manager-level excise taxes with respect to prohibited tax shelter transactions to which tax-exempt entities are parties; sections 6033(a)(2) and 6011(g), relating to certain disclosure obligations with respect to such transactions; and sections 6011 and 6071, relating to the requirement of a return and time for filing with respect to section 4965 taxes. In this issue of the Bulletin, the IRS is issuing cross-referencing temporary regulations that provide guidance under section 6033(a)(2), relating to certain disclosure obligations with respect to prohibited tax shelter transactions (T.D. 9335); and sections 6011 and 6071, relating to the requirement of a return and time for filing with respect to section 4965 taxes (T.D. 9334). This action is necessary to implement section 516 of the Tax Increase Prevention Reconciliation Act of 2005. These proposed regulations affect a broad array of tax-exempt entities, including charities,

state and local government entities, Indian tribal governments and employee benefit plans, as well as entity managers of these entities.

DATES: Written or electronic comments and requests for a public hearing must be received by October 4, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–142039–06; REG–139268–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–142039–06, REG–139268–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–142039–06; REG–139268–06). A public hearing may be scheduled if requested.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Galina Kolomietz, (202) 622–6070 or Michael Blumenfeld, (202) 622–1124; concerning submission of comments and requests for a public hearing, Richard Hurst, *Richard.A.Hurst@irscounsel.treas.gov* (not toll-free numbers). For questions specifically relating to qualified pension plans, individual retirement accounts, and similar tax-favored savings arrangements, contact Dana Barry, (202) 622–6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The collection of information in this proposed regulation is in §301.6011(g)–1. The collection of information in §301.6011(g)–1 flows from section 6011(g) which requires a taxable party to a prohibited tax shelter transaction to disclose to any tax-exempt entity that is a party to the transaction that the transaction is a prohibited tax shelter transaction. The likely recordkeepers are taxable entities or individuals that participate in prohibited tax shelter transactions. Estimated number of recordkeepers: 1250 to 6500. The information that is required to be collected for purposes of §301.6011(g)–1 is a subset of information that is required to be collected in order to complete and file Form 8886, "*Reportable Transaction Disclosure Statement*." The estimated paperwork burden for taxpayers filling out Form 8886 is approved under OMB number 1545–1800 and is as follows:

Recordkeeping	6 hr., 13 min.
Learning about the law or the form	4 hr., 28 min.
Preparing, copying, assembling, and sending the form to the IRS	4 hr., 46 min.

Based on the numbers above, the total estimated burden per recordkeeper complying with the disclosure requirement in §301.6011(g)–1 will not exceed 15 hr., 27 min. This burden has been submitted to the Office of Management and Budget for review.

Books and records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Background

The Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), enacted on May 17, 2006, defines certain transactions as prohibited tax shelter transactions and imposes excise taxes and disclosure requirements with respect to prohibited tax shelter transactions to which a tax-exempt entity is a party. Section 516 of TIPRA creates new section 4965 and amends sections 6033(a)(2) and 6011(g) of the Code.

On July 11, 2006, the IRS released Notice 2006–65, 2006–31 I.R.B. 102, which alerted taxpayers to the new provisions and solicited comments regarding these provisions. One hundred written comments and numerous phone calls were received in response to the request for comments contained in Notice 2006–65. On February 7, 2007, the IRS released Notice 2007–18, 2007–9 I.R.B. 608, which provided interim guidance regarding the circumstances under which a tax-exempt entity will be treated as a party to a prohibited tax shelter transaction and regarding the allocation to various periods of net income and proceeds attributable to a prohibited tax shelter transaction, including amounts received prior to the effective date of the section 4965 tax. Notice 2007–18 also solicited comments from the public regarding these and other issues raised by section 4965. Eight written comments and numerous phone calls were received in response to the request for comments contained in Notice 2007–18. See §601.601(d)(2)(ii)(*b*).

The comments received in response to Notice 2006–65 and Notice 2007–18 addressed all aspects of the new excise taxes and disclosure requirements. While some comments discussed the implications of a broad application of the new excise taxes and disclosure requirements, commentators generally responded favorably to Congress' effort to restrict tax-exempt entities from being involved in Federal tax avoidance schemes. Commentators noted the lack of meaningful penalties prior to TIPRA for tax-exempt entities involved in tax shelter transactions and the need for disclosure in the case where a tax-exempt entity is improperly using its tax-exempt status to facilitate a tax shelter transaction. After consideration of all comments received, the IRS and the Treasury Department are issuing the following proposed regulations and soliciting comments thereon. The major areas of comments and the IRS and Treasury Department's responses thereto are discussed in the following sections.

Explanation of Provisions

Covered Tax-Exempt Entities

Section 4965(c) defines the term "tax-exempt entity" for section 4965 purposes by reference to sections 501(c), 501(d), 170(c), 7701(a)(40), 4979(e) (paragraphs (1), (2) and (3)), 529, 457(b), and 4973(a). The proposed regulations describe the types of entities captured by the statutory cross-references in section 4965(c).

Definition of Prohibited Tax Shelter Transactions

Section 4965(e) defines the term "prohibited tax shelter transaction" by reference to section 6707A(c)(1) and (c)(2). In accordance with the statutory definition, the proposed regulations define the term "prohibited tax shelter transaction" by reference to the definition of the term "reportable transaction" in section 6707A(c)(1) and (c)(2) and the regulations under section 6011. The proposed regulations define a subsequently listed transaction as a transaction (other than a reportable transaction within the meaning of section 6707A(c)(1)) to which a tax-exempt entity becomes a party before the transaction becomes a listed transaction within the meaning of section 6707A(c)(2).

Several commentators expressed concern over the severe penalties imposed on tax-exempt entities and entity managers for participating in many common and legitimate transactions which have no tax avoidance purpose, yet may fall within the definition of prohibited tax shelter transaction. The commentators suggested that the IRS and the Treasury Department carve out certain types of transactions from the definition of "prohibited tax shelter transaction" or revise current listing procedures to give taxpayers an opportunity to object to the identification of a specific transaction as a tax avoidance transaction. Some commentators recommended that any future published guidance which designates a transaction as a listed or reportable transaction be issued with a prospective effective date and state that it will not apply retroactively. Several commentators requested that the proposed regulations identify listed, subsequently listed, confidential and contractual protection transactions that would not be treated as prohibited tax shelter transactions for purposes of section 4965. The above recommendations are not adopted in these proposed regulations because section 4965 defines the term "prohibited tax shelter transaction" by reference to the existing reportable transaction regime. Any additions to, or exclusions from, the definition of reportable transactions, or any changes to the current listing procedures, must be made within the framework of section 6011 rather than section 4965.

One commentator suggested that the term "reportable transaction" should be narrowly interpreted for purposes of section 4965. However, this term already has been defined under section 6011, and consequently, these proposed regulations interpret it consistently for section 4965 and section 6011 purposes.

Definition of Tax-Exempt Party to a Prohibited Tax Shelter Transaction

Excise taxes under section 4965 apply only if a tax-exempt entity is a party to a prohibited tax shelter transaction. A number of commentators requested guidance in determining when a tax-exempt entity is a party to a prohibited tax shelter transaction. Notice 2007–18 defined the term *party* as a tax-exempt entity that facilitates a prohibited tax shelter transaction by reason of its tax-exempt, tax indifferent or tax-favored status. The proposed regulations incorporate this definition of the term *party*. Notice 2007–18 also notified the public that the IRS and the Treasury Department would provide a broader definition of the term *party* in future guidance in accordance with section 4965. Consistent with Notice 2007–18, the proposed regulations define the term *party* for purposes of sections 4965 and 6033(a)(2) to include a tax-exempt entity that enters into a listed transaction and reflects on its tax return a reduction or elimination of its liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction.

Several commentators specifically requested that the proposed regulations address under what circumstances, if any, a tax-exempt entity may be treated as a party to a prohibited tax shelter transaction if the tax-exempt entity is an investor in a partnership, hedge fund or other conduit. Invoking the language in the legislative history to section 4965, commentators recommended that the IRS and Treasury Department establish a rule or a safe harbor that would treat an investor in an indirect investment activity as being a party for section 4965 purposes only in limited circumstances.

As illustrated by an example in the proposed regulations, a tax-exempt entity does not become a party to a prohibited tax shelter transaction solely because it invests in an entity that in turn becomes involved in a prohibited tax shelter transaction. To be considered a "party" under the proposed regulations, the tax-exempt entity must either facilitate the prohibited tax shelter transaction by reason of its tax-exempt, tax indifferent or tax-favored status, or must treat the prohibited tax shelter transaction on its tax return as reducing or eliminating its own Federal tax liability. The IRS and the Treasury Department request comments on any further clarifications that may be helpful in reflecting the intended application of the statute as expressed in the legislative history.

Entity Managers and Related Definitions

The proposed regulations clarify the definition of the term "entity manager" in section 4965(d) and provide guidance on persons who could be entity managers pursuant to a delegation of authority from other entity managers.

The proposed regulations also define the term "approve or otherwise cause." Under section 4965(a)(2), an entity manager may be liable for the manager-level excise tax only if the manager "approves such entity as (or otherwise causes such entity to be) a party" to a prohibited tax shelter transaction and knows or has reason to know the transaction is a prohibited tax shelter transaction. The proposed regulations generally limit the definition of "approving or otherwise causing" to affirmative actions of persons who, individually or as members of a collective body, have the authority to commit the entity to the transaction.

One commentator requested guidance on whether entity managers may be liable

for section 4965 taxes in successor-in-interest situations. Several commentators requested guidance on the consequences under section 4965 of the exercise or nonexercise of certain options pursuant to the terms of the transaction. In response to these comments, the proposed regulations provide rules for successor-in-interest situations and the consequences of the exercise or nonexercise of certain options.

Meaning of "Knows or Has Reason to Know"

The level of tax imposed on the tax-exempt entity under section 4965(b)(1) depends upon whether the entity knows or has reason to know, at the time it enters into the transaction, that it is becoming a party to a prohibited tax shelter transaction. The liability of the entity manager for the tax under section 4965(b)(2) depends on whether the entity manager knows or has reason to know that the transaction is a prohibited tax shelter transaction at the time of approving or otherwise causing the entity to be a party to the transaction. The proposed regulations treat the entity as knowing or having reason to know if its manager(s) knew or had to reason to know and provide rules for determining whether entity managers knew or had reason to know. The "reason-to-know" rules in these proposed regulations are consistent with the "reason-to-know" and "should have known" standards under other provisions of the Code.

Commentators recommended that the IRS and the Treasury Department not treat receipt of a disclosure statement regarding a transaction by the tax-exempt entity as conclusive evidence that the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction. The proposed regulations adopt this recommendation and provide that receipt by an entity manager of a disclosure statement in advance of a transaction is a relevant factor but, by itself, does not necessarily demonstrate that the tax-exempt entity or any of its managers knew or had reason to know that the transaction was a prohibited tax shelter transaction.

Taxes on Prohibited Tax Shelter Transactions

Section 4965(b)(1) provides the rules for computing the entity-level excise tax with respect to prohibited tax shelter transactions. Section 4965(b)(2) imposes a flat $20,000 excise tax on any entity manager that approved or otherwise caused the entity to become a party to a prohibited tax shelter transaction. The proposed regulations follow the computational rules in the statute, define the term "taxable year" for purposes of determining the entity-level tax under section 4965, and clarify the timing of the entity manager taxes under section 4965. The proposed regulations provide that entity manager liability for section 4965 taxes is not joint and several.

Definition of Net Income and Proceeds and Their Allocation to Various Periods

The proposed regulations define the terms "net income" and "proceeds" for section 4965 purposes and provide rules regarding the allocation of net income or proceeds attributable to a prohibited tax shelter transaction to various periods, including the appropriate treatment of net income or proceeds received prior to the effective date of the section 4965(a) tax.

Commentators recommended that net income for purposes of section 4965 be determined in a manner consistent with the determination of net income for other purposes of the Code. The proposed regulations adopt this recommendation.

Numerous commentators requested guidance in determining what amounts constitute proceeds for section 4965 purposes and urged the IRS and the Treasury Department to limit the definition of proceeds to the tax-exempt entity's economic return from the transaction. One commentator recommended that return of basis and return of capital be excluded from the definition of proceeds as these amounts are arguably not "attributable to" a prohibited tax shelter transaction. Several commentators recommended that the IRS and the Treasury Department adopt a rule that would exclude from proceeds earnings on certain set-aside amounts that are used to defease the tax-exempt entity's obligations under so-called sale-in, lease-out (SILO) and lease-in, lease-out (LILO) transactions. See Notice 2000–15, 2000–1 C.B. 826, and Notice 2005–13, 2005–1 C.B. 630. Several commentators suggested that nonexercise of options to repurchase in the SILO / LILO context should not be treated as giving rise to net income or proceeds.

The proposed regulations define the term proceeds separately for tax-exempt entities that are involved in prohibited tax shelter transactions to facilitate the tax avoidance of others and tax-exempt entities that are involved in listed transactions for their own tax benefit. In the case of tax-exempt entities that are involved in prohibited tax shelter transactions to facilitate the tax avoidance of others, the proposed regulations define proceeds as the gross amount of the tax-exempt entity's consideration for facilitating the transaction, not reduced by any costs or expenses attributable to the transaction. This definition subjects the tax-exempt party's economic return from the transaction to the entity-level excise tax. In the case of tax-exempt entities that are involved in listed transactions to reduce or eliminate their own tax liability, the proposed regulations define the term proceeds as tax savings purportedly generated by the transaction and claimed by the tax-exempt entity in the tax year.

In Notice 2007–18, the IRS and Treasury Department provided that the allocation of net income and proceeds is determined according to normal tax accounting rules. The proposed regulations incorporate this rule both for purposes of allocating amounts to pre- and post-effective date periods, and allocating amounts to pre- and post-listing periods where a subsequently listed transaction is involved. Under the proposed regulations, tax-exempt entities that have not adopted a method of accounting are required to use the cash method. Several commentators recommended that the IRS adopt a position that net income or proceeds from pre-enactment transactions would not be properly allocable to any periods after the effective date of the section 4965(a) tax. The IRS and the Treasury Department decline to adopt this blanket rule because such rule would be inconsistent with established principles of tax accounting and would conflict with the plain language of the effective date provisions in section 516 of TIPRA.

Effective Dates of the Taxes

In accordance with section 516(d) of TIPRA, the proposed regulations provide that the taxes under section 4965 are effective for taxable years ending after May 17, 2006, with respect to transactions entered into before, on or after such date, except that no tax under section 4965(a) applies with respect to income or proceeds that are properly allocable to any period ending on or before August 15, 2006. The proposed regulations also provide that the 100 percent entity-level tax under section 4965(b)(1)(B) with respect to knowing transactions does not apply to prohibited tax shelter transactions entered into by a tax-exempt entity on or before May 17, 2006 and that the IRS will not assert an entity manager tax under section 4965(b)(2) with respect to any prohibited tax shelter transaction entered into by a tax-exempt entity on or before May 17, 2006. In addition, the proposed regulations provide that the 100 percent entity-level tax under section 4965(b)(1)(B) and the entity manager tax under section 4965(b)(2) do not apply with respect to any subsequently listed transaction.

Numerous commentators questioned whether it would be appropriate to apply the new excise taxes to pre-enactment transactions that already have closed and advocated a narrow application of the new excise taxes to pre-enactment transactions. The commentators argued that it would be unfair to apply the new excise taxes to pre-enactment transactions that have already closed and subject tax-exempt entities to unforeseen, harsh penalties. The commentators recommended that all transactions closed prior to May 17, 2006 be "delisted" for purposes of section 4965. The proposed regulations do not adopt these recommendations as they are inconsistent with the statutory effective date of section 4965 and the statutory definition of prohibited tax shelter transaction.

When finalized, the regulations under section 4965 are proposed to be applicable for taxable years ending after July 6, 2007. Taxpayers may rely on these proposed regulations for periods ending on or before such date.

Disclosure by Tax-exempt Entities that Are Parties to Certain Reportable Transactions

Section 6033(a)(2), as amended by TIPRA, requires every tax-exempt entity that is a party to a prohibited tax shelter transaction to disclose to the IRS, in such form and manner and at such time as determined by the Secretary, such entity's being a party to such transaction and the identity of any other party to the transaction which is known to the tax-exempt entity. The statute gives the IRS discretion with respect to the form, manner and timing of this disclosure. The proposed regulations provide rules regarding the form, manner and timing of this disclosure. With respect to the due date for the disclosure, the proposed regulations provide that, in the case of tax-exempt entities that are involved in prohibited tax shelter transactions to facilitate the tax avoidance of others, the disclosure must be filed by May 15 of the calendar year following the close of the calendar year during which the tax-exempt entity entered into the prohibited tax shelter transaction (or, in the case of subsequently listed transactions, by May 15 of the calendar year following the close of the calendar year during which the transaction was identified by the Secretary as a listed transaction). In the case of tax-exempt entities that are involved in listed transactions to reduce or eliminate their own tax liability, the proposed regulations provide that the disclosure must be filed on or before the date on which the first tax return (whether an original or an amended return) is filed on which the tax-exempt entity reflects a reduction or elimination of its liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction.

Temporary regulations providing the same rules are being issued concurrently with these proposed regulations.

The temporary regulations under section 6033(a)(2) apply to disclosures with respect to transactions entered into by a tax-exempt entity after May 17, 2006. Transition relief is provided with respect to transactions entered into during a transition period beginning on May 18, 2006 and ending on December 31, 2006. The due date for the disclosure with respect to the transactions entered into during the transition period is November 5, 2007 or, in the case of tax-exempt entities that are involved in listed transactions to reduce or eliminate their own tax liability, the later of: the date on which the first tax return (whether an original or an amended return) is filed on which the tax-exempt entity reflects a reduction or elimination of its liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction; or November 5, 2007.

Disclosure by Taxable Party to the Tax-exempt Entity

Section 6011(g), as amended by TIPRA, requires any taxable party to a prohibited tax shelter transaction to notify any tax-exempt entity which is a party to such transaction that the transaction is a prohibited tax shelter transaction. The statute is silent as to how and when the section 6011(g) disclosure needs to be made. The proposed regulations provide rules regarding the form, timing and frequency of the section 6011(g) disclosure. The proposed regulations also explain to whom the section 6011(g) disclosure must be made. With respect to the due date for the disclosure, the proposed regulations provide that the disclosure to each tax-exempt entity that is a party to the transaction must be made within 60 days after the last to occur of: (1) the date the taxable person becomes a taxable party to the transaction; or (2) the date the taxable party knows or has reason to know that the tax-exempt entity is a party to the transaction. No disclosure is required if the taxable party does not know or have reason to know that the tax-exempt entity is a party to the transaction on or before the first date on which the transaction is required to be disclosed by the taxable party under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4.

One commentator recommended that the IRS provide an exception to the disclosure requirements for any transactions for which there would be no income or proceeds subject to the taxes imposed by section 4965. The proposed regulations

do not adopt this recommendation because one of the purposes of section 6011(g) disclosure is to notify the tax-exempt entity that it may have a disclosure obligation under section 6033(a)(2) with respect to the transaction.

When finalized, the proposed regulations under section 6011(g) will apply to disclosures with respect to transactions entered into by a tax-exempt entity after May 17, 2006.

Payment of Section 4965 Taxes

The proposed regulations amend the existing regulations under sections 6011 and 6071 to specify the forms that must be used to pay section 4965 taxes and to provide the due dates for filing these forms. With respect to the due dates, the proposed regulations provide that a return of the entity-level excise tax under section 4965 must be made on or before the due date (not including extensions) for filing the tax-exempt entity's annual information return under section 6033(a)(1). If the tax-exempt entity is not required to file an annual information return, the return of section 4965 taxes must be made on or before the 15th day of the fifth month after the end of the tax-exempt entity's annual accounting period. A return of manager-level excise tax under section 4965 must be made on or before the 15th day of the fifth month following the close of the entity manager's taxable year during which the entity entered into the prohibited tax shelter transaction.

Temporary regulations providing the same rules are being issued concurrently with these proposed regulations.

A commentator recommended that the IRS and the Treasury Department not make the section 4965 excise taxes effective prior to the issuance of final regulations in cases where application of the new law or provisions of the new law is unclear. The proposed regulations do not adopt this recommendation because the effective date for the section 4965 taxes is statutory.

One commentator recommended that the IRS waive the excise taxes under section 4965 in appropriate circumstances. The proposed regulations do not adopt this recommendation as the obligation to pay section 4965 taxes flows directly from the statute, which does not authorize the IRS to waive the entity-level or manager-level taxes.

The amendments and additions to the regulations under sections 6011 and 6071 will be effective on July 6, 2007. Transition relief is provided with respect to returns of section 4965 taxes due on or before October 4, 2007. These returns will be deemed timely if the return is filed and the tax paid before October 4, 2007.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this notice of proposed rulemaking. It is hereby certified that the collection of information in §301.6011(g)–1 will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. 601) (RFA) is not required.

The effect of these proposed regulations on small entities flows directly from the statutes these regulations implement. Section 6011(g), as amended by TIPRA, requires any taxable party to a prohibited tax shelter transaction to notify any tax-exempt entity which is a party to such transaction that the transaction is a prohibited tax shelter transaction. In implementing this statute, §301.6011(g)–1 of the proposed regulations requires every taxable party to a prohibited tax shelter transaction (or a single taxable party acting by designation on behalf of other taxable parties) to provide to every tax-exempt entity that the taxable party knows or has reason to know is a party to the transaction a single statement disclosing that the transaction is a prohibited tax shelter transaction within 60 days after the last to occur: (1) the date the taxable person becomes a taxable party to the transaction; or (2) the date the taxable party knows or has reason to know that the tax-exempt entity is a party to the transaction. Moreover, it is unlikely that a significant number of small businesses will engage in transactions that are subject to disclosure under 301.6011(g). The IRS and the Treasury Department request comments concerning the likelihood that small businesses are engaging in transactions subject to disclosure under this provision.

Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments (a signed original and eight (8) copies) that are submitted timely to the IRS at the address listed in the Addresses section of this document. The IRS and the Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Galina Kolomietz and Dana Barry, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 53, 54, and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6033–5 is added to read as follows:

§1.6033–5 Disclosure by tax-exempt entities that are parties to certain reportable transactions.

[The text of the proposed amendment to §1.6033–5(a) through (g)(1) is the same as the text of §1.6033–5T (a) through (g)(1) published elsewhere in this issue of the Bulletin].

PART 53— FOUNDATION AND SIMILAR EXCISE TAXES

Par. 3. The authority citation for part 53 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 4. Sections 53.4965–1 through 53.4965–9 are added to read as follows:

§53.4965–1 Overview.

(a) *Entity-level excise tax.* Section 4965 imposes two excise taxes with respect to certain tax shelter transactions to which tax-exempt entities are parties. Section 4965(a)(1) imposes an entity-level excise tax on certain tax-exempt entities that are parties to "prohibited tax shelter transactions," as defined in section 4965(e). See §53.4965–2 for the discussion of covered tax-exempt entities. See §53.4965–3 for the definition of prohibited tax shelter transactions. See §53.4965–4 for the definition of tax-exempt party to a prohibited tax shelter transaction. The entity-level excise tax under section 4965(a)(1) is imposed on a specified percentage of the entity's net income or proceeds that are attributable to the transaction for the relevant tax year (or a period within that tax year). The rate of tax depends on whether the entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity became a party to the transaction. See §53.4965–7(a) for the discussion of the entity-level excise tax under section 4965(a)(1). See §53.4965–6 for the discussion of "knowing or having reason to know." See §53.4965–8 for the definition of net income and proceeds and the standard for allocating net income and proceeds that are attributable to a prohibited tax shelter transaction to various periods.

(b) *Manager-level excise tax.* Section 4965(a)(2) imposes a manager-level excise tax on "entity managers," as defined in section 4965(d), of tax-exempt entities who approve the entity as a party (or otherwise cause the entity to be a party) to a prohibited tax shelter transaction and know or have reason to know, at the time the tax-exempt entity enters into the transaction, that the transaction is a prohibited tax shelter transaction. See §53.4965–5 for the definition of entity manager and the meaning of "approving or otherwise causing," and §53.4965–6 for the discussion of "knowing or having reason to know." See §53.4965–7(b) for the discussion of the manager-level excise tax under section 4965(a)(2).

(c) *Effective/applicability dates.* See §53.4965–9 for the discussion of the relevant effective dates.

§53.4965–2 Covered tax-exempt entities

(a) *In general.* Under section 4965(c), the term "tax-exempt entity" refers to entities that are described in sections 501(c), 501(d), or 170(c) (other than the United States), Indian tribal governments (within the meaning of section 7701(a)(40)), and tax-qualified pension plans, individual retirement arrangements and similar tax-favored savings arrangements that are described in sections 4979(e)(1), (2) or (3), 529, 457(b), or 4973(a). The tax-exempt entities referred to in section 4965(c) are divided into two broad categories, non-plan entities and plan entities.

(b) *Non-plan entities.* Non-plan entities are—

(1) Entities described in section 501(c);

(2) Religious or apostolic associations or corporations described in section 501(d);

(3) Entities described in section 170(c), including states, possessions of the United States, the District of Columbia, political subdivisions of states and political subdivisions of possessions of the United States (but not including the United States); and

(4) Indian tribal governments within the meaning of section 7701(a)(40).

(c) *Plan entities.* Plan entities are—

(1) Entities described in section 4979(e)(1) (qualified plans under section 401(a), including qualified cash or deferred arrangements under section 401(k) (including a section 401(k) plan that allows designated Roth contributions));

(2) Entities described in section 4979(e)(2) (annuity plans described in section 403(a));

(3) Entities described in section 4979(e)(3) (annuity contracts described in section 403(b), including a section 403(b) arrangement that allows Roth contributions);

(4) Qualified tuition programs described in section 529;

(5) Eligible deferred compensation plans under section 457(b) that are maintained by a governmental employer as defined in section 457(e)(1)(A);

(6) Arrangements described in section 4973(a) which include—

(i) Individual retirement plans defined in sections 408(a) and (b), including—

(A) Simplified employee pensions (SEPs) under section 408(k);

(B) Simple individual retirement accounts (SIMPLEs) under section 408(p);

(C) Deemed individual retirement accounts or annuities (IRAs) qualified under a qualified plan (deemed IRAs) under section 408(q)); and

(D) Roth IRAs under section 408A.

(ii) Arrangements described in section 220(d) (Archer Medical Savings Accounts (MSAs));

(iii) Arrangements described in section 403(b)(7) (custodial accounts treated as annuity contracts);

(iv) Arrangements described in section 530 (Coverdell education savings accounts); and

(v) Arrangements described in section 223(d) (health savings accounts (HSAs)).

§53.4965–3 Prohibited tax shelter transactions.

(a) *In general.* Under section 4965(e), the term *prohibited tax shelter transaction* means—

(1) Listed transactions within the meaning of section 6707A(c)(2), including subsequently listed transactions described in paragraph (b) of this section; and

(2) Prohibited reportable transactions, which consist of the following reportable transactions within the meaning of section 6707A(c)(1)—

(i) Confidential transactions, as described in §1.6011–4(b)(3) of this chapter; or

(ii) Transactions with contractual protection, as described in §1.6011–4(b)(4) of this chapter.

(b) *Subsequently listed transactions.* A subsequently listed transaction for pur-

poses of section 4965 is a transaction that is identified by the Secretary as a listed transaction after the tax-exempt entity has entered into the transaction and that was not a prohibited reportable transaction (within the meaning of section 4965(e)(1)(C) and paragraph (a)(2) of this section) at the time the entity entered into the transaction.

(c) *Cross-reference*. The determination of whether a transaction is a listed transaction or a prohibited reportable transaction for section 4965 purposes shall be made under the law applicable to section 6707A(c)(1) and (c)(2).

§53.4965–4 Definition of tax-exempt party to a prohibited tax shelter transaction.

(a) *In general*. For purposes of sections 4965 and 6033(a)(2), a tax-exempt entity is a party to a prohibited tax shelter transaction if the entity—

(1) Facilitates a prohibited tax shelter transaction by reason of its tax-exempt, tax indifferent or tax-favored status;

(2) Enters into a listed transaction and the tax-exempt entity's tax return (whether an original or an amended return) reflects a reduction or elimination of its liability for applicable Federal employment, excise or unrelated business income taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction; or

(3) Is identified in published guidance, by type, class or role, as a party to a prohibited tax shelter transaction.

(b) Published guidance may identify which tax-exempt entities, by type, class or role, will not be treated as a party to a prohibited tax shelter transaction for purposes of sections 4965 and 6033(a)(2).

(c) *Examples*. The following examples illustrate the principles of this section:

Example 1. A tax-exempt entity enters into a transaction (Transaction A) with an S corporation. Transaction A is the same as or substantially similar to the transaction identified by the Secretary as a listed transaction in Notice 2004–30, 2004–1 C.B. 828. The tax-exempt entity's role in Transaction A is similar to the role of the tax-exempt party, as described in Notice 2004–30. Under the terms of the transaction, as described in Notice 2004–30, the tax-exempt entity receives the S corporation stock and, due to the tax-exempt entity's tax-exempt status, aids the S corporation and its shareholders in avoiding taxable income. The tax-exempt entity facilitates Transaction A by reason of its tax-exempt, tax indifferent or tax-favored status. Accordingly, the tax-exempt entity is a party to Transaction A for purposes of sections 4965 and 6033(a)(2). See §601.601(d)(2)(ii)(*b*) of this chapter.

Example 2. A tax-exempt entity is a partner in a partnership. The partnership has a number of other taxable and tax-exempt partners. The tax-exempt entity does not control the partnership. The partnership enters into a number of transactions, including a transaction (Transaction B) which is the same as or substantially similar to the transaction identified by the Secretary as a listed transaction in Notice 2002–35, 2002–1 C.B. 992 (as clarified and modified by Notice 2006–16, 2006–1 C.B. 538). The partnership's role in Transaction B is similar to the role of T, as described in Notice 2002–35, that is, the role of the taxpayer claiming the tax benefits from the transaction. The tax-exempt entity's tax returns do not reflect a reduction or elimination of its liability for applicable Federal taxes as a result of Transaction B. The tax and economic consequences from Transaction B to the other partners are not dependent on the tax-exempt entity's tax-exempt, tax indifferent or tax-favored status. Accordingly, the tax-exempt entity does not facilitate Transaction B by reason of its tax-exempt, tax indifferent or tax-favored status. Because the tax-exempt entity's tax returns do not reflect a reduction or elimination of its liability for applicable Federal taxes that is derived directly or indirectly from tax consequences or tax strategy described in the published guidance that lists the transaction, the tax-exempt entity is not a party to Transaction B by reason of paragraph (a)(2) of this section. The tax-exempt entity also has not been identified, by type, class or role, as a party to a prohibited tax shelter transaction in published guidance. Therefore, the tax-exempt entity is not a party to Transaction B for purposes of sections 4965 and 6033(a)(2). See §601.601(d)(2)(ii)(*b*) of this chapter.

(d) *Effective dates*. See §53.4965–9 for the discussion of the relevant applicability dates.

§53.4965–5 Entity managers and related definitions.

(a) *Entity manager of a non-plan entity*—(1) *In general*. Under section 4965(d)(1), an entity manager of a non-plan entity is—

(i) A person with the authority or responsibility similar to that exercised by an officer, director, or trustee of an organization (that is, the non-plan entity); and

(ii) With respect to any act, the person who has final authority or responsibility (either individually or as a member of a collective body) with respect to such act.

(2) *Definition of officer*. For purposes of paragraph (a)(1)(i) of this section, a person is considered to be an officer of the non-plan entity (or to have similar authority or responsibility) if the person—

(i) Is specifically designated as such under the certificate of incorporation, by-laws, or other constitutive documents of the non-plan entity; or

(ii) Regularly exercises general authority to make administrative or policy decisions on behalf of the non-plan entity.

(3) *Exception for acts requiring approval by a superior*. With respect to any act, any person is not described in paragraph (a)(2)(ii) of this section if the person has authority merely to recommend particular administrative or policy decisions, but not to implement them without approval of a superior.

(4) *Delegation of authority*. A person is an entity manager of a non-plan entity within the meaning of paragraph (a)(1)(ii) of this section if, with respect to any prohibited tax shelter transaction, such person has been delegated final authority or responsibility with respect to such transaction (including by transaction type or dollar amount) by a person described in paragraph (a)(1)(i) of this section or the governing board of the entity. For example, an investment manager is an entity manager with respect to a prohibited tax shelter transaction if the non-plan entity's governing body delegated to the investment manager the final authority to make certain investment decisions and, in the exercise of that authority, the manager committed the entity to the transaction. To be considered an entity manager of a non-plan entity within the meaning of paragraph (a)(1)(ii) of this section, a person need not be an employee of the entity. A person is not described in paragraph (a)(1)(ii) of this section if the person is merely implementing a decision made by a superior.

(b) *Entity manager of a plan entity*—(1) *In general*. Under section 4965(d)(2), an entity manager of a plan entity is the person who approves or otherwise causes the entity to be a party to the prohibited tax shelter transaction.

(2) *Special rule for plan participants and beneficiaries who have investment elections*—(i) *Fully self-directed plans or arrangements*. In the case of a fully self-directed qualified plan, IRA, or other savings arrangement (including the case where a plan participant or beneficiary is given a list of prohibited investments, such as collectibles), if the plan participant or beneficiary selected a certain investment and, therefore, approved the plan entity to become a party to a prohibited tax shelter transaction, the plan

participant or the beneficiary is an entity manager.

(ii) *Plans or arrangements with limited investment options.* In the case of a qualified plan, IRA, or other savings arrangement where a plan participant or beneficiary is offered a limited number of investment options from which to choose, the person responsible for determining the pre-selected investment options is an entity manager and the plan participant or the beneficiary generally is not an entity manager.

(c) *Meaning of "approves or otherwise causes"*—(1) *In general.* A person is treated as approving or otherwise causing a tax-exempt entity to become a party to a prohibited tax shelter transaction if the person has the authority to commit the entity to the transaction, either individually or as a member of a collective body, and the person exercises that authority.

(2) *Collective bodies.* If a person shares the authority described in paragraph (c)(1) of this section as a member of a collective body (for example, board of trustees or committee), the person will be considered to have exercised such authority if the person voted in favor of the entity becoming a party to the transaction. However, a member of the collective body will not be treated as having exercised the authority described in paragraph (c)(1) of this section if he or she voted against a resolution that constituted approval or an act that caused the tax-exempt entity to be a party to a prohibited tax shelter transaction, abstained from voting for such approval, or otherwise failed to vote in favor of such approval.

(3) *Exceptions*—(i) *Successor in interest.* If a tax-exempt entity that is a party to a prohibited tax shelter transaction is dissolved, liquidated, or merged into a successor entity, an entity manager of the successor entity will not, solely by reason of the reorganization, be treated as approving or otherwise causing the successor entity to become a party to a prohibited tax shelter transaction, provided that the reorganization of the tax-exempt entity does not result in a material change to the terms of the transaction. For purposes of this paragraph, a material change includes an extension or renewal of the agreement (other than an extension or renewal that results from another party to the transaction unilaterally exercising an option granted by the agreement) or a more than incidental change to any payment under the agreement. A change for the sole purpose of substituting the successor entity for the original tax-exempt party is not a material change.

(ii) *Exercise or nonexercise of options.* Nonexercise of an option pursuant to a transaction involving the tax-exempt entity generally will not constitute an act of approving or causing the entity to be a party to the transaction. If, pursuant to a transaction involving the tax-exempt entity, the entity manager exercises an option (such as a repurchase option), the entity manager will not be subject to the entity manager-level tax if the exercise of the option does not result in the tax-exempt entity becoming a party to a second transaction that is a prohibited tax shelter transaction.

(4) *Example.* The following example illustrates the principles of paragraph (c)(3)(ii) of this section:

Example. In a sale-in, lease-out (SILO) transaction described in Notice 2005–13, 2005–1 C.B. 630, X, which is a non-plan entity, has purported to sell property to Y, a taxable entity and lease it back for a term of years. At the end of the basic lease term, X has the option of "repurchasing" the property from Y for a predetermined purchase price, with funds that have been set aside at the inception of the transaction for that purpose. The entity manager, by deciding to exercise or not exercise the "repurchase" option is not approving or otherwise causing the non-plan entity to become a party to a second prohibited tax shelter transaction. See §601.601(d)(2)(ii)(*b*) of this chapter.

(5) *Coordination with the reason-to-know standard.* The determination that an entity manager approved or caused a tax-exempt entity to be a party to a prohibited tax shelter transaction, by itself, does not establish liability for the section 4965(a)(2) tax. For rules on determining whether an entity manager knew or had reason to know that the transaction was a prohibited tax shelter transaction, see §53.4965–6(b).

(d) *Effective dates.* See §53.4965–9 for the discussion of the relevant applicability dates.

§53.4965–6 Meaning of "knows or has reason to know".

(a) *Attribution to the entity.* An entity will be treated as knowing or having reason to know for section 4965 purposes if one or more of its entity managers knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity manager(s) approved the entity as (or otherwise caused the entity to be) a party to the transaction. The entity shall be attributed the knowledge or reason to know of any entity manager described in §53.4965–5(a)(1)(i) even if that entity manager does not approve the entity as (or otherwise cause the entity to be) a party to the transaction.

(b) *Determining whether an entity manager knew or had reason to know*—(1) *In general.* Whether an entity manager knew or had reason to know that a transaction is a prohibited tax shelter transaction is based on all facts and circumstances. In order for an entity manager to know or have reason to know that a transaction is a prohibited tax shelter transaction, the entity manager must have knowledge of sufficient facts that would lead a reasonable person to conclude that the transaction is a prohibited tax shelter transaction. An entity manager will be considered to have "reason to know" if a reasonable person in the entity manager's circumstances would conclude that the transaction was a prohibited tax shelter transaction based on all the facts reasonably available to the manager at the time of approving the entity as (or otherwise causing the entity to be) a party to the transaction. Factors that will be considered in determining whether a reasonable person in the entity manager's circumstances would conclude that the transaction was a prohibited tax shelter transaction include, but are not limited to—

(i) The presence of tax shelter *indicia* (see paragraph (b)(2) of this section);

(ii) Whether the entity manager received a disclosure statement prior to the consummation of the transaction indicating that the transaction may be a prohibited tax shelter transaction (see paragraph (b)(3) of this section); and

(iii) Whether the entity manager made appropriate inquiries into the transaction (see paragraph (b)(4) of this section).

(2) *Tax-shelter indicia.* The presence of *indicia* that a transaction is a tax shelter will be treated as an indication that the entity manager knew or had reason to know that the transaction was a prohibited tax shelter transaction. Tax shelter *indicia* include but are not limited to—

(i) The transaction is extraordinary for the entity considering prior investment activity;

(ii) The transaction promises an economic return for the organization that is exceptional considering the amount invested by, the participation of, or the absence of risk to the organization; or

(iii) The transaction is of significant size relative to the receipts of the entity.

(3) *Effect of disclosure statements.* Receipt by an entity manager of a statement, including a statement described in section 6011(g), in advance of a transaction that the transaction may be a prohibited tax shelter transaction (or a statement that a partnership, hedge fund or other investment conduit may engage in a prohibited tax shelter transaction in the future) is a factor relevant in the determination of whether the entity manager knew or had reason to know that the transaction is a prohibited transaction. However, an entity manager will not be treated as knowing or having reason to know that the transaction was a prohibited tax shelter transaction solely because the entity manager receives such a disclosure.

(4) *Appropriate inquiries.* What inquiries are appropriate will be determined from the facts and circumstances of each case. For example, if one or more tax shelter *indicia* are present or if an entity manager receives a disclosure statement described in paragraph (b)(3) of this section, an entity manager has a responsibility to inquire further whether the transaction is a prohibited tax shelter transaction.

(c) *Reliance on professional advice*—(1) *In general.* An entity manager is not required to obtain the advice of a professional tax advisor to establish that the entity manager made appropriate inquiries. Moreover, not seeking professional advice, by itself, shall not give rise to an inference that the entity manager had reason to know that a transaction is a prohibited tax shelter transaction.

(2) *Reliance on written opinion of professional tax advisor.* An entity manager may establish that he or she did not have a reason to know that a transaction was a prohibited tax shelter transaction at the time the tax-exempt entity entered into the transaction if the entity manager reasonably, and in good faith, relied on the written opinion of a professional tax advisor. Reliance on the written opinion of a professional tax advisor establishes that the entity manager did not have reason to know if, taking into account all the facts and circumstances, the reliance was reasonable and the entity manager acted in good faith. For example, the entity manager's education, sophistication, and business experience will be relevant in determining whether the reliance was reasonable and made in good faith. In no event will an entity manager be considered to have reasonably relied in good faith on an opinion unless the requirements of this paragraph (c)(2) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the entity manager reasonably relied on the opinion in good faith. For example, reliance may not be reasonable or in good faith if the entity manager knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

(i) *All facts and circumstances considered.* The advice must be based upon all pertinent facts and circumstances and the law as it relates to those facts and circumstances. The requirements of this paragraph (c)(2) are not satisfied if the entity manager fails to disclose a fact that it knows, or reasonably should know, is relevant to determining whether the transaction is a prohibited tax shelter transaction.

(ii) *No unreasonable assumptions.* The advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the entity manager or any other person (including another party to the transaction or a material advisor within the meaning of sections 6111 and 6112.

(iii) *"More likely than not" opinion.* The written opinion of the professional tax advisor must apply the appropriate law to the facts and, based on this analysis, must conclude that the transaction was not a prohibited tax shelter transaction at a "more likely than not" level of certainty at the time the entity manager approved the entity (or otherwise caused the entity) to be a party to the transaction.

(3) *Special rule.* An entity manager's reliance on a written opinion of a professional tax advisor will not be considered reasonable if the advisor is, or is related to a person who is, a material advisor with respect to the transaction within the meaning of sections 6111 and 6112.

(d) *Subsequently listed transactions.* An entity manager will not be treated as knowing or having reason to know that a transaction (other than a prohibited reportable transaction as defined in section 4965(e)(1)(C) and §53.4965–3(a)(2)) is a prohibited tax shelter transaction if the entity enters into the transaction before the date on which the transaction is identified by the Secretary as a listed transaction.

(e) *Effective/applicability dates.* See §53.4965–9 for the discussion of the relevant applicability dates.

§53.4965–7 Taxes on prohibited tax shelter transactions.

(a) *Entity-level taxes*—(1) *In general.* Entity-level excise taxes apply to non-plan entities (as defined in §53.4965–2(b)) that are parties to prohibited tax shelter transactions.

(i) *Prohibited tax shelter transactions other than subsequently listed transactions*—(A) *Amount of tax if the entity did not know and did not have reason to know.* If the tax-exempt entity did not know and did not have reason to know that the transaction was a prohibited tax shelter transaction at the time the entity entered into the transaction, the tax is the highest rate of tax under section 11 multiplied by the greater of—

(*1*) The entity's net income with respect to the prohibited tax shelter transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year; or

(*2*) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction.

(B) *Amount of tax if the entity knew or had reason to know.* If the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time the entity entered into the transaction, the tax is the greater of—

(*1*) 100 percent of the entity's net income with respect to the transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year; or

(*2*) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction.

(ii) *Subsequently listed transactions*—(A) *In general.* In the case of a subsequently listed transaction (as defined in section 4965(e)(2) and §53.4965–3(b)), the tax-exempt entity's income and proceeds attributable to the transaction are allocated between the period before the transaction became listed and the period beginning on the date the transaction became listed. See §53.4965–8 for the standard for allocating net income or proceeds to various periods. The tax for each taxable year is the highest rate of tax under section 11 multiplied by the greater of—

(*1*) The entity's net income with respect to the subsequently listed transaction (after taking into account any tax imposed by Subtitle D, other than by this section, with respect to such transaction) for the taxable year that is allocable to the period beginning on the later of the date such transaction is identified by the Secretary as a listed transaction or the first day of the taxable year; or

(*2*) 75 percent of the proceeds received by the entity for the taxable year that are attributable to such transaction and allocable to the period beginning on the later of the date such transaction is identified by the Secretary as a listed transaction or the first day of the taxable year.

(B) *No increase in tax.* The 100 percent tax under section 4965(b)(1)(B) and §53.4965–7(a)(1)(i)(B) does not apply to any subsequently listed transaction (as defined in section 4965(e)(2) and §53.4965–3(b)) entered into by a tax-exempt entity before the date on which the transaction is identified by the Secretary as a listed transaction.

(2) *Taxable year.* The excise tax imposed under section 4965(a)(1) applies for the taxable year in which the entity becomes a party to the prohibited tax shelter transaction and any subsequent taxable year for which the entity has net income or proceeds attributable to the transaction. A taxable year for tax-exempt entities is the calendar year or fiscal year, as applicable, depending on the basis on which the tax-exempt entity keeps its books for Federal income tax purposes. If a tax-exempt entity has not established a taxable year for Federal income tax purposes, the entity's taxable year for the purpose of determining the amount and timing of net income and proceeds attributable to a prohibited tax shelter transaction will be deemed to be the annual period the entity uses in keeping its books and records.

(b) *Manager-level taxes*—(1) *Amount of tax.* If any entity manager approved or otherwise caused the tax-exempt entity to become a party to a prohibited tax shelter transaction and knew or had reason to know that the transaction was a prohibited tax shelter transaction, such entity manager is liable for the $20,000 tax. See §53.4965–5(d) for the meaning of approved or otherwise caused. See §53.4965–6 for the meaning of knew or had reason to know.

(2) *Timing of the entity manager tax.* If a tax-exempt entity enters into a prohibited tax shelter transaction during a taxable year of an entity manager, then the entity manager that approved or otherwise caused the tax-exempt entity to become a party to the transaction is liable for the entity manager tax for that taxable year if the entity manager knew or had reason to know that the transaction was a prohibited tax shelter transaction.

(3) *Example.* The application of paragraph (b)(2) of this section is illustrated by the following example:

Example. The entity manager's taxable year is the calendar year. On December 1, 2006, the entity manager approved or otherwise caused the tax-exempt entity to become a party to a transaction that the entity manager knew or had reason to know was a prohibited tax shelter transaction. The tax-exempt entity entered into the transaction on January 31, 2007. The entity manager is liable for the entity manager level tax for the entity manager's 2007 taxable year, during which the tax-exempt entity entered into the prohibited tax shelter transaction.

(4) *Separate liability.* If more than one entity manager approved or caused a tax-exempt entity to become a party to a prohibited tax shelter transaction while knowing (or having reason to know) that the transaction was a prohibited tax shelter transaction, then each such entity manager is separately (that is, not jointly and severally) liable for the entity manager-level tax with respect to the transaction.

(c) *Effective dates.* See §53.4965–9 for the discussion of the relevant effective dates.

§53.4965–8 Definition of net income and proceeds and standard for allocating net income or proceeds to various periods.

(a) *In general.* For purposes of section 4965(a), the amount and the timing of the net income and proceeds attributable to the prohibited tax shelter transaction will be computed in a manner consistent with the substance of the transaction. In determining the substance of listed transactions, the IRS will look to, among other items, the listing guidance and any subsequent guidance published in the Internal Revenue Bulletin relating to the transaction.

(b) *Definition of net income and proceeds*—(1) *Net income.* A tax-exempt entity's net income attributable to a prohibited tax shelter transaction is its gross income derived from the transaction reduced by those deductions that are attributable to the transaction and that would be allowed by chapter 1 of the Internal Revenue Code if the tax-exempt entity were treated as a taxable entity for this purpose, and further reduced by taxes imposed by Subtitle D, other than by this section, with respect to the transaction.

(2) *Proceeds*—(i) *Tax-exempt entities that facilitate the transaction by reason of their tax-exempt, tax indifferent or tax-favored status.* Solely for purposes of section 4965, in the case of a tax-exempt entity that is a party to the transaction by reason of §53.4965–4(a)(1) of this chapter, the term *proceeds* means the gross amount of the tax-exempt entity's consideration for facilitating the transaction, not reduced for any costs or expenses attributable to the transaction. Published guidance with respect to a particular prohibited tax shelter transaction may designate additional amounts as proceeds from the transaction for section 4965 purposes.

(ii) *Tax-exempt entities that enter into transactions to reduce or eliminate their liability for applicable Federal taxes.* For purposes of section 4965, in the case of a tax-exempt entity that is a party to the transaction by reason of §53.4965–4(a)(2) of this chapter, the term *proceeds* means tax savings purportedly generated by the transaction and claimed by the tax-exempt entity on its tax return with respect to the tax year. Published guidance with respect to a particular prohibited tax shelter transaction may designate additional amounts as proceeds from the transaction for section 4965 purposes.

(iii) *Treatment of gifts and contributions.* To the extent not otherwise included in the definition of proceeds in paragraphs (b)(2)(i) and (ii) of this section, any amount that is a gift or a contribution

to a tax-exempt entity and is attributable to a prohibited tax shelter transaction will be treated as proceeds for section 4965 purposes, unreduced by any associated expenses.

(c) *Allocation of net income and proceeds*—(1) *In general.* For purposes of section 4965(a), the net income and proceeds attributable to a prohibited tax shelter transaction must be allocated in a manner consistent with the tax-exempt entity's established method of accounting for Federal income tax purposes. If the tax-exempt entity has not established a method of accounting for Federal income tax purposes, solely for purposes of section 4965(a) the tax-exempt entity must use the cash receipts and disbursements method of accounting (cash method) provided for in section 446 of the Internal Revenue Code to determine the amount and timing of net income and proceeds attributable to a prohibited tax shelter transaction.

(2) *Special rule.* If a tax-exempt entity has established a method of accounting other than the cash method, the tax-exempt entity may nevertheless use the cash method of accounting to determine the amount of the net income and proceeds—

(i) Attributable to a prohibited tax shelter transaction entered into prior to the effective date of section 4965(a) tax and allocable to pre- and post-effective date periods; or

(ii) Attributable to a subsequently listed transaction and allocable to pre- and post-listing periods.

(d) *Transition year rules.* In the case of the taxable year that includes August 16, 2006 (the transition year), the IRS will treat the period beginning on the first day of the transition year and ending on August 15, 2006, and the period beginning on August 16, 2006, and ending on the last day of the transition year as short taxable years. This treatment is solely for purposes of allocating net income or proceeds under section 4965. The tax-exempt entity continues to file tax returns for the full taxable year, does not file tax returns with respect to these deemed short taxable years and does not otherwise take the short taxable years into account for Federal tax purposes. Accordingly, the net income or proceeds that are properly allocated to the transition year in accordance with this section will be treated as allocable to the period—

(1) Ending on or before August 15, 2006 (and accordingly not subject to tax under section 4965(a)) to the extent such net income or proceeds would have been properly taken into account in accordance with this section by the tax-exempt entity in the deemed short year ending on August 15, 2006; and

(2) Beginning after August 15, 2006 (and accordingly subject to tax under section 4965(a)) to the extent such income or proceeds would have been properly taken into account in accordance with this section by the tax-exempt entity in the short year beginning August 16, 2006.

(e) *Allocation to pre- and post-listing periods.* If a transaction other than a prohibited reportable transaction (as defined in section 4965(e)(1)(C) and §53.4965–3(a)(2)) to which the tax-exempt entity is a party is subsequently identified in published guidance as a listed transaction during a taxable year of the entity (the listing year) in which it has net income or proceeds attributable to the transaction, the net income or proceeds are allocated between the pre- and post-listing periods. The IRS will treat the period beginning on the first day of the listing year and ending on the day immediately preceding the date of the listing, and the period beginning on the date of the listing and ending on the last day of the listing year as short taxable years. This treatment is solely for purposes of allocating net income or proceeds under section 4965. The tax-exempt entity continues to file tax returns for the full taxable year, does not file tax returns with respect to these deemed short taxable years and does not otherwise take the short taxable years into account for Federal tax purposes. Accordingly, the net income or proceeds that are properly allocated to the listing year in accordance with this section will be treated as allocable to the period—

(1) Ending before the date of the listing (and accordingly not subject to tax under section 4965(a)) to the extent such net income or proceeds would have been properly taken into account in accordance with this section by the tax-exempt entity in the deemed short year ending on the day immediately preceding the date of the listing; and

(2) Beginning on the date of the listing (and accordingly subject to tax under section 4965(a)) to the extent such income or proceeds would have been properly taken into account in accordance with this section by the tax-exempt entity in the short year beginning on the date of the listing.

(f) *Examples.* The following examples illustrate the allocation rules of this section:

Example 1. (i) In 1999, X, a calendar year non-plan entity using the cash method of accounting, entered into a lease-in/lease-out transaction (LILO) substantially similar to the transaction described in Notice 2000–15, 2000–1 C.B. 826 (describing Rev. Rul. 99–14, 1999–1 C.B. 835, superseded by Rev. Rul. 2002–69, 2002–2 C.B. 760). In 1999, X purported to lease property to Y pursuant to a "head lease," and Y purported to lease the property back to X pursuant to a "sublease" of a shorter term. In form, X received $268M as an advance payment of head lease rent. Of this amount, $200M had been, in form, financed by a nonrecourse loan obtained by Y. X deposited the $200M with a "debt payment undertaker." This served to defease both a portion of X's rent obligation under its sublease and Y's repayment obligation under the nonrecourse loan. Of the remainder of the $268M advance head lease rent payment, X deposited $54M with an "equity payment undertaker." This served to defease the remainder of X's rent obligation under the sublease as well as the exercise price of X's end-of-sublease term purchase option. This amount inures to the benefit of Y and enables Y to recover its investment in the transaction and a return on that investment. In substance, the $54M is a loan from Y to X. X retained the remaining $14M of the advance head lease rent payment. In substance, this represents a fee for X's participation in the transaction. See §601.601(d)(2)(ii)(b) of this chapter.

(ii) According to the substance of the transaction, the head lease, sublease and nonrecourse debt will be ignored for Federal income tax purposes. Therefore, any net income or proceeds resulting from these elements of the transaction will not be considered net income or proceeds attributable to the LILO transaction for purposes of section 4965(a). The $54M deemed loan from Y to X and the $14M fee are not ignored for Federal income tax purposes.

(iii) Under X's established cash basis method of accounting, any net income received in 1999 and attributable to the LILO transaction is allocated to X's December 31, 1999, tax year for purposes of section 4965. The $14M fee received in 1999, and which constitutes proceeds of the transaction, is likewise allocated to that tax year. Because the 1999 tax year is before the effective date of the section 4965 tax, X will not be subject to any excise tax under section 4965 for the amounts received in 1999.

(iv) Any earnings on the amount deposited with the equity payment undertaker that constitute gross income to X will be reduced by X's original issue discount deductions with respect to the deemed loan from Y, in determining X's net income from the transaction.

Example 2. B, a non-plan entity using the cash method of accounting, has an annual accounting period that ends on December 31, 2006. B entered into a

prohibited tax shelter transaction on March 15, 2006. On that date, B received a payment of $600,000 as a fee for its involvement in the transaction. B received no other proceeds or income attributable to this transaction in 2006. Under B's method of accounting, the payment received by B on March 15, 2006, is taken into account in the deemed short year ending on August 15, 2006. Accordingly, solely for purposes of section 4965, the payment is treated as allocable solely to the period ending on or before August 15, 2006, and is not subject to the excise tax imposed by section 4965(a).

Example 3. The facts are the same as in *Example 2*, except that B received an additional payment of $400,000 on September 30, 2006. Under B's method of accounting, the payment received by B on September 30, 2006, is taken into account in the deemed short year beginning on August 16, 2006. Accordingly, solely for purposes of section 4965, the $400,000 payment is treated as allocable to the period beginning after August 15, 2006, and is subject to the excise tax imposed by section 4965(a).

Example 4. C, a non-plan entity using the cash method of accounting, has an annual accounting period that ends on December 31. C entered into a prohibited tax shelter transaction on May 1, 2005. On March 15, 2007, C received a payment of $580,000 attributable to the transaction. On June 1, 2007, the transaction is identified by the IRS in published guidance as a listed transaction. On June 15, 2007, C received an additional payment of $400,000 attributable to the transaction. Under C's method of accounting, the payments received on March 15, 2007, and June 15, 2007, are taken into account in 2007. The IRS will treat the period beginning on January 1, 2007, and ending on May 31, 2007, and the period beginning on June 1, 2007, and ending on December 31, 2007, as short taxable years. The payment received by C on March 15, 2007, is taken into account in the deemed short year ending on May 31, 2007. Accordingly, solely for purposes of section 4965, the payment is treated as allocable solely to the pre-listing period, and is not subject to the excise tax imposed by section 4965(a). The payment received by C on June 15, 2007, is taken into account in the deemed short year beginning on June 1, 2007. Accordingly, solely for purposes of section 4965, the payment is treated as allocable to the post-listing period, and is subject to the excise tax imposed by section 4965(a).

(g) *Effective/applicability dates*. See §53.4965–9 for the discussion of the relevant applicability dates.

§53.4965–9 Effective/applicability dates.

(a) *In general*. The taxes under section 4965(a) and §53.4965–7 are effective for taxable years ending after May 17, 2006, with respect to transactions entered into before, on or after that date, except that no tax under section 4965(a) applies with respect to income or proceeds that are properly allocable to any period ending on or before August 15, 2006.

(b) *Applicability of the regulations*. Except as provided in paragraph (c) of this section, upon publication of final regulations, §§53.4965–1 through 53.4965–8 of this chapter will apply to taxable years ending after July 6, 2007. A tax-exempt entity may rely on the provisions of §§53.4965–1 through 53.4965–8 for taxable years ending on or before July 6, 2007.

(c) *Effective date with respect to certain knowing transactions*—(1) *Entity-level tax*. The 100 percent tax under section 4965(b)(1)(B) and §53.4965–7(a)(1)(i)(B) does not apply to prohibited tax shelter transactions entered into by a tax-exempt entity on or before May 17, 2006.

(2) *Manager-level tax*. The IRS will not assert that an entity manager who approved or caused a tax-exempt entity to become a party to a prohibited tax shelter transaction is liable for the entity manager tax under section 4965(b)(2) and §53.4965–7(b)(1) with respect to the transaction if the tax-exempt entity entered into such transaction prior to May 17, 2006.

Par. 5. In §53.6071–1, paragraphs (g) and (h) are added to read as follows:

§53.6071–1 Time for filing returns.

* * * * *

(g) [The text of the proposed amendment to §53.6071–1(g) is the same as the text of §53.6071–1T(g) published elsewhere in this issue of the Bulletin].

(h) [The text of the proposed amendment to §53.6071–1(h) is the same as the text of §53.6071–1T(h) published elsewhere in this issue of the Bulletin].

PART 54—EXCISE TAXES, PENSIONS, REPORTING AND RECORDKEEPING REQUIREMENTS

Par. 6. The authority citation for part 54 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 7. In §54.6011–1, paragraphs (c) and (d) are added to read as follows:

§54.6011–1 General requirement of return, statement or list.

* * * * *

(c) [The text of the proposed amendment to §54.6011–1(c) is the same as the text of §54.6011–1T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of the proposed amendment to §54.6011–1(d) is the same as the text of §54.6011–1T(d) published elsewhere in this issue of the Bulletin].

PART 301—PROCEDURE AND ADMINISTRATION

Par. 8. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 9. Section 301.6011(g)–1 is added to read as follows:

§301.6011(g)–1 Disclosure by taxable party to the tax-exempt entity.

(a) *Requirement of disclosure*—(1) *In general*. Except as provided in paragraph (d)(2) of this section, any taxable party (as defined in paragraph (c) of this section) to a prohibited tax shelter transaction (as defined in section 4965(e) and §53.4965–3 of this chapter) must disclose by statement to each tax-exempt entity (as defined in section 4965(c) and §53.4965–2 of this chapter) that the taxable party knows or has reason to know is a party to such transaction (as defined in paragraph (b) of this section) that the transaction is a prohibited tax shelter transaction.

(2) *Determining whether a taxable party knows or has reason to know*. Whether a taxable party knows or has reason to know that a tax-exempt entity is a party to a prohibited tax shelter transaction is based on all the facts and circumstances. If the taxable party knows or has reason to know that a prohibited tax shelter transaction involves a tax-exempt, tax indifferent or tax-favored entity, relevant factors for determining whether the taxable party knows or has reason to know that a specific tax-exempt entity is a party to the transaction include—

(i) The extent of the efforts made to determine whether a tax-exempt entity is facilitating the transaction by reason of its tax-exempt, tax indifferent or tax-favored status (or is identified in published guidance, by type, class or role, as a party to the transaction); and

(ii) If a tax-exempt entity is facilitating the transaction by reason of its tax-exempt, tax indifferent or tax-favored status (or is identified in published guidance, by type, class or role, as a party to the transaction), the extent of the efforts made to determine the identity of the tax-exempt entity.

(b) *Definition of tax-exempt party to a prohibited tax shelter transaction*—(1) *In*

general. For purposes of section 6011(g), a tax-exempt entity is a party to a prohibited tax shelter transaction if the entity—

(i) Facilitates a prohibited tax shelter transaction by reason of its tax-exempt, tax indifferent or tax-favored status; or

(ii) Is identified in published guidance, by type, class or role, as a party to a prohibited tax shelter transaction.

(2) Published guidance may identify which tax-exempt entities, by type, class or role, will not be treated as a party to a prohibited tax shelter transaction for purposes of section 6011(g).

(c) *Definition of taxable party*—(1) *In general.* For purposes of this section, the term *taxable party* means—

(i) A person who has entered into and participates or expects to participate in the transaction under §§1.6011–4(c)(3)(i)(A), (B), or (C), 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter; or

(ii) A person who is designated as a taxable party by the Secretary in published guidance.

(2) *Special rules*—(i) *Certain listed transactions.* If a transaction that was otherwise not a prohibited tax shelter transaction becomes a listed transaction after the filing of a person's tax return (including an amended return) reflecting either tax consequences or a tax strategy described in the published guidance listing the transaction (or a tax benefit derived from tax consequences or a tax strategy described in the published guidance listing the transaction), the person is a taxable party beginning on the date the transaction is described as a listed transaction in published guidance.

(ii) *Persons designated as non-parties.* Published guidance may identify which persons, by type, class or role, will not be treated as a party to a prohibited tax shelter transaction for purposes of section 6011(g).

(d) *Time for providing disclosure statement*—(1) *In general.* A taxable party to a prohibited tax shelter transaction must make the disclosure required by this section to each tax-exempt entity that the taxable party knows or has reason to know is a party to the transaction within 60 days after the last to occur of—

(i) The date the person becomes a taxable party to the transaction within the meaning of paragraph (c) of this section; or

(ii) The date the taxable party knows or has reason to know that the tax-exempt entity is a party to the transaction within the meaning of paragraph (b) of this section.

(2) *Termination of a disclosure obligation.* A person shall not be required to provide the disclosure otherwise required by this section if the person does not know or have reason to know that the tax-exempt entity is a party to the transaction within the meaning of paragraph (b) of this section on or before the first date on which the transaction is required to be disclosed by the person under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter.

(3) Disclosure is not required with respect to any prohibited tax shelter transaction entered into by a tax-exempt entity on or before May 17, 2006.

(e) *Frequency of disclosure.* One disclosure statement is required per tax-exempt entity per transaction. See paragraph (h) of this section for rules relating to designation agreements.

(f) *Form and content of disclosure statement.* The statement disclosing to the tax-exempt entity that the transaction is a prohibited tax shelter transaction must be a written statement that—

(1) Identifies the type of prohibited tax shelter transaction (including the published guidance citation for a listed transaction); and

(2) States that the tax-exempt entity's involvement in the transaction may subject either it or its entity manager(s) or both to excise taxes under section 4965 and to disclosure obligations under section 6033(a) of the Internal Revenue Code.

(g) *To whom disclosure is made.* The disclosure statement must be provided—

(1) In the case of a non-plan entity as defined in §53.4965–2(b) of this chapter, to—

(i) Any entity manager of the tax-exempt entity with authority or responsibility similar to that exercised by an officer, director or trustee of an organization; or

(ii) If a person described in paragraph (g)(1)(i) of this section is not known, to the primary contact on the transaction.

(2) In the case of a plan entity as defined in §53.4965–2(c) of this chapter, including a fully self-directed qualified plan, IRA, or other savings arrangement, to any entity manager of the plan entity who approved or otherwise caused the entity to become a party to the prohibited tax shelter transaction.

(h) *Designation agreements.* If more than one taxable party is required to disclose a prohibited tax shelter transaction under this section, the taxable parties may designate by written agreement a single taxable party to disclose the transaction. The transaction must then be disclosed in accordance with this section. The designation of one taxable party to disclose the transaction does not relieve the other taxable parties of their obligation to disclose the transaction to a tax-exempt entity that is a party to the transaction in accordance with this section, if the designated taxable party fails to disclose the transaction to the tax-exempt entity in a timely manner.

(i) *Penalty for failure to provide disclosure statement.* See section 6707A for penalties applicable to failure to disclose a prohibited tax shelter transaction in accordance with this section.

(j) *Effective/applicability date.* This section will apply with respect to transactions entered into by a tax-exempt entity after May 17, 2006.

Par. 10. Section 301.6033–5 is added to read as follows:

§301.6033–5 Disclosure by tax-exempt entities that are parties to certain reportable transactions.

[The text of the proposed amendment to §301.6033–5 is the same as the text of §301.6033–5T published elsewhere in this issue of the Bulletin].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 5, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 6, 2007, 72 F.R. 36927)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-72

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007

Name	Address	Designation	Date of Reinstatement
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007

Name	Address	Designation	Date of Suspension
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007

Name	Address	Designation	Date of Suspension
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007

Name	Address	Designation	Date of Suspension
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–73

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on August 20, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or

omissions of the organization that were the basis for revocation.

The Dale and Johanna
Brunken Foundation
Salt Lake City, UT

Osterville Village Association
Osterville, MA

Epley Family Foundation
Salt Lake City, UT

Ohio Veterans Coalition, Inc.
Akron, OH

United States Historical Society
Richmond, VA

MOP Non-Profit, Inc.
Detroit, MI

Del Sol Foundation
Downey, CA

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1256.—Section 1256 Contracts Marked to Market

A notice clarifies that foreign currency options, whether or not the underlying currency is one in which positions are traded through regulated futures contracts, are not foreign currency contracts as defined in section 1256(g)(2). See Notice 2007-71, page 472.

Section 1397E.—Credit to Holders of Qualified Zone Academy Bonds

26 CFR 1.1397E–1: Qualified zone academy bonds.

T.D. 9339

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations that provide guidance to state and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds on the program requirements for qualified zone academy bonds. The temporary regulations implement the amendments to section 1397E of the Internal Revenue Code (Code) (discussed in this preamble) and provide guidance on the maximum term, permissible use of proceeds, and remedial actions for qualified zone academy bonds. The text of these temporary regulations also serves as the text of the proposed regulations (REG–121475–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. The portions of this rule that are final regulations provide necessary cross-references to the temporary regulations.

DATES: *Effective Date:* These regulations are effective on September 14, 2007.

Applicability Date: For dates of applicability, see §1.1397E–1T(m) of these regulations.

FOR FURTHER INFORMATION CONTACT: Timothy L. Jones or Zoran Stojanovic, (202) 622–3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1908. Responses to this collection of information are required to obtain or retain a benefit.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 1397E(a) of the Code provides that an eligible taxpayer (within the meaning of section 1397E(d)(6)) that holds a qualified zone academy bond ("QZAB" or "QZABs") on a credit allowance date is allowed a credit against Federal income tax for the taxable year that includes the credit allowance date. In general, a QZAB is a bond issued by a state or local government to finance certain eligible public school purposes under section 1397E(d). Section 1397E(b) provides that the amount of the QZAB credit equals the product of the credit rate and the face amount of the bond held by the taxpayer on the credit allowance date. Under section 1397E(b)(2), the credit rate is determined by the Treasury Department and equals the percentage that the Department estimates generally will permit the issuance of QZABs without discount and without interest cost to the issuer. Section 1397E(i)(1) defines "credit allowance date" as the last day of the one-year period beginning on the issue date of the issue and the last day of each successive one-year period thereafter. Under section 1397E(d)(3), the maximum term of a QZAB is determined by the Treasury Department and equals the term that the Treasury Department estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond.

Section 1397E(j) provides that the amount of the QZAB credit allowed to the taxpayer is included in the taxpayer's gross income.

Section 1397E(e) imposes a national limitation on the amount of QZABs that may be issued for each calendar year. The limitation is allocated by the Treasury Department among the States on the basis of their respective populations of individuals below the poverty line.

Section 1397E was amended by section 107 of the Tax Relief and Health Care Act of 2006, Public Law 109–432, 120 Stat. 2922 (2006) (the "2006 Act"), by adding certain requirements for a bond to be a QZAB. In general, the 2006 Act added a new five-year spending period requirement, arbitrage investment restrictions, and information reporting requirements. Specifically, the 2006 Act added new section 1397E(f), which generally imposes

spending period restrictions under which an issuer of QZABs must reasonably expect, as of the issue date, that: (1) at least 95 percent of the proceeds from the sale of the issue are to be spent for one or more qualified purposes with respect to qualified zone academies within the 5-year period beginning on the issue date of the QZAB; (2) a binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the issue will be incurred within the six-month period beginning on the issue date of the QZAB; and (3) such purposes will be completed with due diligence and the proceeds from the sale of the issue will be spent with due diligence. New Section 1397E(f)(2) added by the 2006 Act provides authority to the Secretary of the Treasury to extend the five-year spending period. To the extent that less than 95 percent of the proceeds of the issue are spent within the five-year spending period (plus any extension granted by the Secretary of the Treasury), the 2006 Act requires the issuer to redeem the nonqualified bonds within 90 days after the end of such period.

In addition, the 2006 Act added new section 1397E(g), which generally requires that an issue of QZABs must satisfy the arbitrage investment restrictions of section 148 with respect to the proceeds of the issue.

Finally, the 2006 Act added new section 1397E(h), which generally requires that issuers of QZABs submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt state or local bonds.

Temporary regulations (T.D. 8755, 1998–1 C.B. 653) interpreting section 1397E were published on January 7, 1998 (63 FR 671), and amended on July 1, 1999 (T.D. 8826, 1999–2 C.B. 107 [64 FR 35573]). Final regulations under section 1397E (T.D. 8903, 2000–2 C.B. 352) were published on September 26, 2000 (65 FR 57732) (the "Final Regulations"). On March 26, 2004, a notice of proposed rulemaking (REG–121475–03, 2004–1 C.B. 793) was published in the **Federal Register** (69 FR 15747) (the "2004 Proposed Regulations"). The 2004 Proposed Regulations proposed to amend the existing Final Regulations by providing guidance on the maximum term, permissible use of proceeds, and remedial actions for QZABs. A public hearing was scheduled for July 21, 2004. The public hearing was cancelled because no requests to speak were received. Written comments on the 2004 Proposed Regulations were received. After consideration of the written comments, and in light of the statutory changes made by the 2006 Act, the need for regulatory guidance on those statutory changes, and the close connection between that needed guidance and the guidance in the 2004 Proposed Regulations, the IRS and the Treasury Department have determined to issue coordinated guidance in these temporary regulations (the "Temporary Regulations"), with an opportunity for public comment in the corresponding proposed regulations (the "Proposed Regulations"). Set forth in this preamble is an explanation of certain provisions of the Temporary Regulations.

Explanation of Provisions

I. *Certain Definitions*

A. *In general*

The Temporary Regulations employ certain definitions used in the tax-exempt bond area. Thus, the Temporary Regulations employ certain definitions used for general tax-exempt bond purposes in §1.150–1 and certain definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in §1.148–1(b).

B. *Definitions of various types of proceeds in general*

In general, §1.148–1(b) defines "sale proceeds" as any amounts actually or constructively received from the sale of an issue, including amounts used to pay underwriters' discount or compensation. In addition, §1.148–1(b) defines "investment proceeds" to mean any amounts actually or constructively received from investing proceeds of an issue. Further, §1.148–1(c) defines "replacement proceeds" to include certain amounts with a reasonable nexus to a bond issue, such as sinking funds reasonably expected to be used to pay debt service on a bond issue and pledged funds pledged to pay debt service on a bond issue with a reasonable assurance that the funds will be available to pay such debt service.

C. *Proceeds for purposes of the use and spending requirements*

In general, the Temporary Regulations provide that, for purposes of the QZAB provisions regarding the use and expenditure of proceeds for qualified purposes within prescribed periods, "proceeds" means sale proceeds, as defined in §1.148–1(b), plus investment proceeds, as defined in §1.148–1(b). Thus, under the Temporary Regulations, the requirement in section 1397E(d)(1)(A) to use at least 95 percent of the proceeds of an issue for a qualified purpose with respect to a qualified zone academy applies by taking into account both the sale proceeds of the issue and any investment proceeds received from investing those sale proceeds. Similarly, under the Temporary Regulations, the requirement in section 1397E(f) to spend at least 95 percent of the proceeds from the sale of an issue on qualified purposes within a five-year period and the associated requirements in section 1397E(f) apply to both sale proceeds of an issue and investment proceeds derived from investing sale proceeds.

Some commentators suggested that, for purposes of the 95-percent test, the definition of "proceeds" should be limited to sale proceeds and should exclude amounts received from investing sale proceeds. These commentators suggested that, when sizing a bond issue to comply with the 95-percent test, it could be difficult for an issuer to include investment earnings because interest rates may be volatile and the timing of expenditures may be uncertain. The IRS and the Treasury Department have considered this comment and have concluded that the definition of proceeds in the 2004 Proposed Regulations that applies for purposes of the 95-percent test is appropriate to ensure the use and expenditures of proceeds of QZABs for one or more qualified purposes under section 1397E(d)(5) and (f). Thus, the Temporary Regulations retain this provision. This approach is consistent with the view that, for purposes of certain similar provisions on qualified private activity bonds under section 141, which are based on use of 95% of the net proceeds, as defined in section 150(a)(3), for qualified purposes, net proceeds properly include both sale proceeds and investment proceeds pending expenditures for ultimate qualified

governmental purposes, with certain reductions inapplicable to QZABs.

D. *Proceeds for purposes of private business contribution*

Section 1397E(d)(1)(C)(ii) provides that a bond is a QZAB only if, among other requirements, the issuer certifies that it has written assurances that the private business contribution requirement of section 1397E(d)(2) will be met with respect to the qualified zone academy. Section 1397E(d)(2)(A) provides that the private business contribution requirement is met if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions (as defined in section 1397E(d)(2)(B)) having a present value (as of the issue date of the issue) of not less than ten percent of the proceeds of the issue. The 2004 Proposed Regulations provide that, for purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means sale proceeds, as defined in §1.148–1(b), without regard to any investment proceeds received or expected to be received from investing those sale proceeds. Commentators supported this narrower definition of "proceeds" in the 2004 Proposed Regulations for purposes of the private business contribution requirement. The Temporary Regulations retain this provision.

II. *Maximum Term*

Section 1397E(d)(3) provides that the Secretary of the Treasury Department shall determine, during each calendar month, the maximum term for QZABs issued during the following calendar month. Section 1397E(d)(3) states that the maximum term shall be the term that the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond. Section 1.1397E–1(d) of the existing Final Regulations provides that the maximum term for a QZAB is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted applicable Federal rate (AFR), compounded semi-annually, for the month in which the bond is issued. The IRS publishes the long-term adjusted AFR each month in a revenue ruling. See §601.601(d)(2)(ii)(*b*).

Section 1397E(b)(2) provides that the Secretary shall determine, during each calendar month, a credit rate for QZABs issued during the following calendar month. Section 1.1397E–1(b) provides that the Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates generally will permit the issuance of a QZAB without discount and without interest cost to the issuer. Notice 99–35, 1999–2 C.B. 26, see §601.601(d)(2)(ii)(*b*) ("Notice 99–35"), indicates that, until further notice, the credit rate for a QZAB will be published daily by the Bureau of Public Debt on its Internet site for State and Local Government Series securities (*https://www.treasurydirect.gov*). Notice 99–35 also provides that the credit rate shall be applied to a QZAB on the first day on which there is a binding contract in writing for the sale or exchange of the bond. Notice 99–35 states that the credit rate will be determined by the Treasury Department based on its estimate of the yield on outstanding AA rated corporate bonds of a similar maturity for the business day immediately prior to the date on which there is a binding contract in writing for the sale or exchange of the bond.

Prior to the issuance of the 2004 Proposed Regulations, questions were raised regarding the maximum term of a QZAB that is sold in one month and issued in another month. Section 1.1397E–1(d) of the existing Final Regulations provides that the maximum term is determined based on the month in which the bond is issued. However, under Notice 99–35, the credit rate for a QZAB is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond. The credit rate and maximum term should be determined on the same day because the credit rate for a bond depends on its maximum term. Accordingly, the 2004 Proposed Regulations would amend §1.1397E–1(d) to provide that the maximum term for a QZAB is determined based on the first day on which there is a binding contract in writing for the sale or exchange of the bond.

Commentators supported the maximum term provisions in the 2004 Proposed Regulations. The Temporary Regulations retain these provisions.

At the present time, the Treasury Department is continuing its current practice of publishing the credit rate and maximum term for QZABs on the Bureau of Public Debt's Internet site for State and Local Government Series securities (*https://www.treasurydirect.gov*).

III. *Use of Proceeds and Remedial Actions*

A. *In general*

Section 1397E(d)(1) provides that a bond issued as part of an issue is a QZAB only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)) and the issue meets the requirements of section 1397E(f) (relating to spending periods), section 1397E(g) (relating to arbitrage), and section 1397E(h) (relating to information reporting requirements). Section 1397E(d)(5) defines "qualified purposes" for any qualified zone academy to include: (i) rehabilitating or repairing the public school facility in which such academy is established, (ii) providing equipment for use at such academy, (iii) developing course materials for education to be provided at such academy, and (iv) training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines "qualified zone academy" as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level if: (1) the public school or program is designed in cooperation with business in accordance with section 1397E(d)(4)(A)(i); (2) students in the public school or program will be subject to the same academic standards and assessments as other students educated by the eligible local education agency; (3) the comprehensive education plan of the public school or program is approved by the eligible local education agency; and (4) the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the issue date of the bonds) that at least 35 percent of the students attending the school or par-

ticipating in the program will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act.

B. *Compliance with 95-percent test*

1. *In general*

The 2004 Proposed Regulations provide guidance on compliance with the 95-percent test in section 1397E(d)(1)(A). Specifically, the 2004 Proposed Regulations provide that, in general, an issue must satisfy two requirements to comply with section 1397E(d)(1)(A). First, the issuer must reasonably expect, as of the issue date of the issue, to use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). Second, except as otherwise provided in the remedial action provisions of the 2004 Proposed Regulations, at least 95 percent of the proceeds of the issue must actually be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision). For these purposes, under the 2004 Proposed Regulations, any unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy during any period that the issuer reasonably expects that those proceeds will be spent with due diligence for a qualified purpose with respect to a qualified zone academy.

Some commentators suggested a modification of the requirement in the 2004 Proposed Regulations that at least 95 percent of the proceeds of an issue both be reasonably expected to be used and actually be used for a qualified purpose for the entire term of the issue. Specifically, these commentators requested that the requirement be altered to conform to the tax-exempt bond provisions of §1.141–2(d), which look to a similar standard based on reasonable expectations and deliberate actions within an issuer's control, with certain exceptions for involuntary conversions and actions in response to directives from the Federal government. These commentators noted that use of the standards under section 141 would be appropriate because the statutory language of sections 141 and 1397E both use the phrase "are to be used." In substance, the standards for interpreting this phrase under the 2004 Proposed Regulations and under section 141 both incorporate reasonable expectations and actual use, with certain special exceptions to actual use in the case of the standard under section 141. The IRS and the Treasury Department believe, however, that compliance standards for the actual use of proceeds appropriately may take into account the particular governmental program involved.

The Temporary Regulations do not adopt the suggestion to conform the 95-percent test for QZABs to the deliberate action provisions of §1.141–2(d). The Temporary Regulations retain the proposed standard based on reasonable expectations and actual use. The actual use test is set forth under section 1397E(f)(3), as introduced by the 2006 Act, and is appropriate for the circumstances involved with QZABs. In addition, the control-based exceptions to actual use under the deliberate action standard under section 141 raise certain administrability concerns in the context of QZABs. For example, it may be particularly difficult to determine if a loss of qualified zone academy status is within an issuer's control.

The Temporary Regulations provide guidance on the spending period requirements introduced by the 2006 Act in section 1397E(f). Specifically, the Temporary Regulations provide that an issuer must both reasonably expect to spend and actually spend at least 95 percent of the proceeds of an issue of QZABs within the five-year period beginning on the issue date of the issue of QZABs (or be subject to the additional requirement to redeem bonds from unspent proceeds at the end of that five-year period). The Temporary Regulations clarify that the various requirements relating to "reasonable expectations" for the use of proceeds of QZABs and actual actions to proceed with "due diligence" to spend such proceeds on qualified purposes are based on objective reasonableness standards, as used in the definition of "reasonable expectations or reasonableness" in §1.148–1(b) of the arbitrage regulations.

2. *Proceeds spent for rehabilitation, repair or equipment*

Section 1397E(d)(5)(A) and (B) provides that the term "qualified purpose" with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established, and providing equipment for use at such academy. The 2004 Proposed Regulations specify that, if proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that (1) the property financed with those proceeds is used for the purposes of the academy and (2) the academy maintains its status as a qualified zone academy. For this purpose, the retirement from service of financed property due to normal wear or obsolescence does not cause the property not to be used for a qualified purpose with respect to a qualified zone academy.

The Temporary Regulations provide guidance on the applicable standard for determining whether proceeds of QZABs are used for a qualified purpose of "rehabiliting" a public school facility under section 1397E(d)(5)(A), based on a known existing standard used for purposes of the rehabilitation tax credit under section 47. In particular, in determining whether proceeds of QZABs are used for a qualified purpose of "rehabilitating" a public school facility under section 1397E(d)(5)(A), rules similar to those used for purposes of the rehabilitation tax credit in section 47(c) (other than sections 47(c)(1)(B)and 47(c)(2)(B)(v)) shall apply. Set forth in this preamble is a general description of certain aspects of this rehabilitation expenditure standard. In general, the rehabilitation standard under section 47 requires a substantial rehabilitation involving a building that already has been placed in service and a rehabilitation process that preserves specified portions of the existing walls of the building. Specifically, at least 50 percent of the existing external walls of the rehabilitated building must be retained as external walls, at least 75 percent of the existing external walls must be retained as internal or external walls, and at least 75 percent of the existing internal

structural framework must be retained. Under this rehabilitation standard, eligible rehabilitation expenditures include some expenditures for reconstruction, subject, however, to the foregoing restrictions on retention of certain percentages of the existing walls. In addition, however, under this rehabilitation standard, eligible rehabilitation expenditures do not include expenditures to enlarge existing buildings or expenditures to acquire existing buildings. In adopting the rehabilitation standard used in section 47 for purpose of section 1397E, the IRS and the Treasury Department declined to adopt one public comment which suggested that rehabilitation should include complete reconstruction of a building. Here, the IRS and the Treasury Department determined that such a broad interpretation of rehabilitation effectively to include new construction would be beyond Congressional intent.

3. *Proceeds spent to develop course materials or train teachers*

Section 1397E(d)(5)(C) and (D) provides that the term "qualified purpose" with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. The 2004 Proposed Regulations provide that, if proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure. Commentators supported this provision of the 2004 Proposed Regulations. The Temporary Regulations retain this provision.

4. *Special rule for determining status as qualified zone academy*

Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community, or there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act.

For purposes of determining whether an issue complies with section 1397E(d)(4)(A)(iv), the 2004 Proposed Regulations provide that a public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the issue date of the issue. Commentators agreed with this provision of the 2004 Proposed Regulations relating to empowerment zones and enterprise communities. The Temporary Regulations retain this provision.

Commentators also requested clarification of the relevant time period for determining compliance with the 35-percent free or reduced-cost school lunch program test. The Temporary Regulations provide that the test looks to whether there is a reasonable expectation (as of the issue date of the bonds) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches during the one-year period following the date the bonds are issued.

C. *Remedial actions*

1. *In general*

Prior to the issuance of the 2004 Proposed Regulations, comments were received requesting guidance specifying remedial actions that may be taken to cure a violation of the 95-percent test in section 1397E(d)(1)(A). The 2004 Proposed Regulations specify two remedial actions that may be taken in certain circumstances if less than 95 percent of the proceeds of an issue actually are used for a qualified purpose with respect to a qualified zone academy. These remedial actions are available only if the issuer reasonably expected on the issue date of the bonds that: (1) the issue would meet the requirements of section 1397E(f)(1)(A), (B), and (C); and (2) at least 95 percent of the proceeds of the issue would be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision).

As discussed in this preamble, the two remedial actions specified in the 2004 Proposed Regulations are (1) redemption or defeasance of the nonqualified bonds, and (2) alternative use of the disposition proceeds. If the applicable requirements are met, the redemption or defeasance remedial action is available to cure any failure to satisfy the 95-percent test that was not reasonably expected as of the issue date. The alternative use of disposition proceeds remedial action applies only to certain dispositions of financed property for cash.

Commentators recommended that the 2004 Proposed Regulations be amended to provide additional flexibility for issuers if the failure to properly use proceeds is based on a loss of status of the public school or academic program as a qualified zone academy. Consistent with the 2006 Act, the Treasury Department and the IRS have concluded that the remedial actions of redemption and defeasance in the 2004 Proposed Regulations will adequately address situations where there has been a disqualifying change in the status of an academy. The Temporary Regulations retain these two remedial actions with certain modifications relating to the amendments to section 1397E introduced by the 2006 Act.

2. *Redemption or defeasance of nonqualified bonds*

Under the 2004 Proposed Regulations, a redemption or defeasance remedial action is taken if: (1) all of the nonqualified bonds of the issue (determined by applying the principles of §1.142–2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; (2) if any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs; or (3) if the failure to properly use proceeds is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, all of the disposition proceeds (as de-

fined in §1.141–12(c)(1)) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a *pro rata* portion of the nonqualified bonds of the issue.

The Temporary Regulations retain the remedial actions described in this preamble but, in accordance with new section 1397E(f)(3), the Temporary Regulations limit defeasance of nonqualified bonds to bonds the proceeds of which have actually been spent for a qualified purpose with respect to a qualified academy within the 5-year period beginning on the issue date of the bonds. For proceeds that have not been spent within the 5-year period, the only remedial action available to the issuer is redemption of nonqualified bonds under the principles of section 142.

3. *Failure to properly use proceeds*

For unspent proceeds, the 2004 Proposed Regulations provide that a failure to properly use proceeds occurs on the earlier of: (1) the first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; or (2) the first date on which the issuer fails to have a reasonable expectation to proceed with due diligence to spend at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy.

The Temporary Regulations retain the provisions concerning the failure to properly use unspent proceeds but implement section 1397E(f)(1)(A) by adding a provision that improper use also occurs if 95 percent of the bond proceeds have not been properly spent within the 5-year period beginning on the day the bonds are issued.

For proceeds that have been spent for rehabilitation, repair or equipment described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, the 2004 Proposed Regulations provide that a failure to properly use proceeds occurs on the earlier of: (1) the first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; and (2) the first date on which an action is taken that causes the issuer to fail actually to use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy. If proceeds have been spent for course materials or training described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds under the 2004 Proposed Regulations. The Temporary Regulations retain these provisions.

4. *Defeasance escrow*

The 2004 Proposed Regulations define "defeasance escrow" as an irrevocable escrow established to retire bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire the bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in §1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of §1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of §1.148–5(d)(6).

Under the 2004 Proposed Regulations, the issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under §1.148–3 (or at such other time or in such other manner as the Commissioner may prescribe), 100 percent of the investment earnings on amounts in the defeasance escrow. For this purpose, the first computation period begins on the date on which the failure to properly use proceeds occurs.

Under the 2004 Proposed Regulations, proceeds of QZABs (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) are not permitted to be used to redeem or defease the nonqualified bonds. In addition, the issuer must provide written notice to the Commissioner of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

Commentators suggested various modifications to the requirement that issuers rebate to the United States 100 percent of the investment earnings on amounts in a defeasance escrow. Alternative approaches suggested by commentators included: (1) limiting the rebate requirement to investment earnings in excess of the yield on the issue of QZABs; (2) limiting the rebate amount to investment earnings in excess of the total debt service requirements to be paid out of the defeasance escrow; and (3) limiting the rebate amount to the amount of the QZAB credit.

The IRS and Treasury Department have concluded that the rebate requirement should only apply to earnings in excess of the yield on the issue of QZABs. Thus, the Temporary Regulations provide that the issuer of QZABs with a defeasance escrow must rebate to United States any investment earnings in the defeasance escrow that are in excess of the yield, as defined in §1.148–1(b), on the issue of QZABs. For this purpose, the credit rate for the QZAB issue is not included in the yield on the issue.

Some commentators suggested that the first computation period for rebate purposes begin on the date the defeasance escrow is established, rather than the date on which the failure to properly use proceeds occurs. These commentators noted that the 2004 Proposed Regulations create a possible 90-day period during which an issuer would be required to compute yield on an escrow that is yet to be established. The Temporary Regulations adopt the change in start date for the computation period in accordance with this comment.

One commentator recommended that certain small, low-wealth local education agencies be exempt from the rebate requirement. The IRS and the Treasury Department have considered this recommendation and have concluded that the rebate requirement is appropriate to ensure compliance with the 95-percent use-of-proceeds requirement of section 1397E(d)(1)(A), regardless of the size or wealth of the local education agency. Thus, the Temporary Regulations do not adopt this recommendation.

Some commentators suggested that the regulations provide that a defeasance of a QZAB in the context of taking a remedial action not be treated as a significant modification (within the meaning of §1.1001–3) and reissuance of the QZAB. The Temporary Regulations do not address the circumstances in which a reissuance of a QZAB will occur. The Temporary Regulations do provide, how-

ever, that, for purposes of determining whether the establishing of a defeasance escrow as a remedial action results in an exchange under §1.1001–1(a), the QZAB is treated as a tax-exempt bond under §1.1001–3(e)(5)(ii)(B)(*1*). Section 1.1001–3(e)(5)(ii)(B)(*1*) provides that a defeasance of a tax-exempt bond is not a significant modification even if the issuer is released from any liability to make payments under the instrument if the defeasance occurs by operation of the terms of the original bond and the issuer places in trust government securities or tax-exempt government bonds that are reasonably expected to provide interest and principal payments sufficient to satisfy the payment obligations under the bond.

5. *Alternative use of disposition proceeds*

The alternative use of disposition proceeds remedial action in the 2004 Proposed Regulations has four requirements. First, the failure to properly use proceeds must be a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition must be exclusively cash. Second, the issuer must reasonably expect as of the date of the disposition that: (1) all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, will be spent within two years after the date of the disposition for a qualified purpose with respect to a qualified zone academy; or (2) to the extent not expected to be so spent, used within 90 days after the date of the disposition to take a redemption or defeasance remedial action. Third, the disposition proceeds, plus any amounts received from investing the disposition proceeds, must be treated as proceeds for purposes of section 1397E. Fourth, if all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, are not actually spent for a qualified purpose within the two-year period beginning on the date of the disposition (or used within 90 days after the date of the disposition to take a redemption or defeasance remedial action), the remainder of such amounts must be used within 90 days after the end of that two-year period for a redemption or defeasance remedial action.

Some commentators recommended that the alternative use of disposition proceeds remedial action be modified to provide that the amounts relating to a disposition that are required to be spent for a qualified purpose be capped at the principal amount of the QZAB outstanding at the time of the disposition. The IRS and Treasury Department have considered this comment and have concluded that the requirement in the 2004 Proposed Regulations that all of the disposition proceeds, plus any amounts received from investing the disposition proceeds, be spent for a qualified purpose is appropriate to ensure that QZABs are issued for qualified purposes. Thus, the Temporary Regulations do not adopt this comment.

D. *Payment of principal, interest or redemption price*

The 2004 Proposed Regulations provide that the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5). Thus, the use of proceeds of a bond to refund another bond is not a qualified purpose under the 2004 Proposed Regulations. In addition, the use of proceeds of a bond to fund a sinking fund to repay the bond is not a qualified purpose under the 2004 Proposed Regulations.

One commentator recommended that the 2004 Proposed Regulations be modified to permit proceeds of a QZAB to be used to repay an interim bridge loan incurred with the explicit intent to be refinanced with a subsequent issuance. In response to this comment, the Temporary Regulations provide an exception to the general rule that the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose under section 1397E(d)(5).

IV. *Arbitrage Investment Restrictions*

New section 1397E(g) added by the 2006 Act provides that the arbitrage requirements of section 148 applicable to tax-exempt state or local governmental bonds under section 103 also apply to QZABs. The Temporary Regulations provide guidance regarding the application of the arbitrage requirements to QZABs.

In general, under section 148, subject to various prompt spending exceptions (for example, the 18-month prompt spending exception to arbitrage rebate for capital projects under §1.148–7(d) and the 2-year construction spending exception to arbitrage rebate under section 148(f)(4)(C) and §1.148–7(e)) and other specified exceptions (for example, the *bona fide* debt service exception for certain long-term tax-exempt governmental, non-private activity bonds under section 148(f)(4)(A)), the arbitrage investment restrictions, including the yield restrictions and the arbitrage rebate requirement, apply broadly to "gross proceeds" of tax-exempt bonds. "Gross proceeds" represents a broad catch-all category of bond proceeds which includes various subsidiary types of proceeds, including, among others, "sale proceeds" derived from the sale of bonds, "investment proceeds" derived from investing proceeds of bonds, and "replacement proceeds" with a reasonable nexus to a bond issue (for example, sinking funds reasonably expected to be used to pay debt service on bonds and pledged funds used to secure bonds).

The Temporary Regulations provide that, except as otherwise provided, the arbitrage investment restrictions under section 148 and the exceptions to those restrictions apply to gross proceeds of QZABs issued under section 1397E to the same extent and in the same manner as they apply to gross proceeds of tax-exempt state or local governmental bonds issued under section 103. For this purpose, references in the arbitrage restrictions to tax-exempt bonds generally shall be deemed to refer to QZABs and, to the extent that any particular arbitrage restriction depends on whether bonds are private activity bonds under section 141, the determination of whether QZABs are private activity bonds shall be based on the general definition of private activity bonds under section 141.

The Temporary Regulations provide limited guidance to tailor the application of the arbitrage investment restrictions to QZABs in certain specific respects. Thus, the Temporary Regulations provide that a five-year temporary period exception to the arbitrage yield restriction requirement applies to proceeds of QZABs if an issuer reasonably expects to spend 95 percent of the proceeds of an issue of QZABs for qualified purposes within the 5-year period beginning on the issue date of the QZABs.

The Temporary Regulations provide that, in determining the yield on an issue of QZABs for arbitrage purposes, the QZAB credit is disregarded. Here, yield focuses on yield paid by the issuer on the QZABs rather than the tax credit benefit to the investor.

The Temporary Regulations provide that the yield restriction rules are inapplicable to amounts placed in defeasance escrow as a remedial action. The Treasury Department and IRS have a concern that QZAB issuers may be unable to find appropriate investments of the amounts in the escrow at or below the yield on the bonds.

The Temporary Regulations provide that the exception to arbitrage yield restriction for certain investments in non-AMT tax-exempt bonds is inapplicable to QZABs. The IRS and the Treasury Department have a concern about the clear arbitrage investment potential associated with investing zero-yielding QZABs in non-AMT tax-exempt bond investments at materially higher yields.

The Temporary Regulations provide that, in determining whether an issue of QZABs qualifies for the small issuer exception to the arbitrage rebate requirement under section 148(f)(4)(D), both QZABs and tax-exempt bonds (other than private activity bonds) that are reasonably expected to be issued or actually issued by the QZAB issuer (and other covered on-behalf-of entities and subordinate entities) within a calendar year are taken into account in measuring the applicable size limitation.

Finally, consistent with the treatment of defeasance escrows for purposes of yield restriction, in applying the small issuer exception to the rebate of earnings from investments of amounts in a defeasance escrow, the Temporary Regulations provide that the issuer is not treated as a small issuer and amounts earned from such investments must be rebated to the United States.

V. *Information Reporting Requirement*

Issuers of QZABs must submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt State or local bonds at the same time and manner as those reports are required to be submitted to the IRS on such forms as shall be prescribed by the Commissioner for such purpose.

Effective/Applicability Dates

In general, except as otherwise provided, the Temporary Regulations apply to bonds sold on or after September 14, 2007.

In general, except as otherwise provided, §1.1397E–1(h)(2), (i), and (j) of the Temporary Regulations regarding the five-year spending period, the arbitrage investment restrictions, and the information reporting requirement added by the 2006 Act apply to bonds issued pursuant to allocations of the national qualified zone academy bond volume cap authority arising in calendar years after 2005 and sold on or after September 14, 2007.

Issuers and taxpayers may apply the Temporary Regulations in whole, but not in part, to bonds sold before September 14, 2007.

Certain other special effective dates apply to particular provisions under §1.1397E–1T(m).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this Bulletin. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Timothy L. Jones and Zoran Stojanovic, Office of Division Counsel/Associate Chief Counsel, IRS (Tax Exempt and Governmental Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority 26 U.S.C. 7805 * * *

Section 1.1397E–1T also issued under 26 U.S.C. 1397E. * * *

Par. 2. Section 1.1397E–1 is amended by:

1. Redesignating paragraphs (i), (j) and (k) as (k), (l) and (m), respectively.

2. Adding new paragraphs (i) and (j).

3. Revising newly-designated paragraph (m).

The additions and revisions read as follows:

§1.1397E–1 Qualified zone academy bonds.

* * * * *

(i) and (j) [Reserved]. For further guidance, see §1.1397E–1T(i) and (j).

* * * * *

(m) *Effective/applicability dates*. Except as provided in this paragraph (m), this section applies, to bonds sold on or after September 26, 2000. Each of paragraphs (c) and (k) of this section may be applied by issuers to bonds that are sold before September 26, 2000.

Par. 3. Section 1.1397E–1T is added to read as follows:

§1.1397E–1T Qualified zone academy bonds (temporary).

(a) *In general*—(1) *Overview*. In general, a qualified zone academy bond (QZAB or QZABs) is a taxable bond issued by a state or local government the proceeds of which are used to improve certain eligible public schools. An eligible taxpayer that holds a QZAB generally is allowed annual Federal income tax credits in lieu of periodic interest payments. These credits compensate the eligible taxpayer for lending money to the issuer and function as payments of interest on the bond. Accordingly, this section generally treats the allowance of a credit as if it

were a payment of interest on the bond. This section also provides other rules for QZABs, including rules governing the credit rate, the private business contribution requirement, the maximum term, use and expenditure of proceeds, remedial actions, eligible issuers, arbitrage investment restrictions, and information reporting.

(2) *Certain definitions*—(i) *In general.* For purposes of this section, except as otherwise provided in this section, the following definitions apply: the definitions set forth in this section; the definitions used for general tax-exempt bond purposes in §1.150–1; and the definitions used for purposes of the arbitrage investment restrictions on tax-exempt bonds in §1.148–1(b).

(ii) *Applicable definition of proceeds*—(A) *Use and expenditure provisions.* Except as provided in paragraphs (a)(2)(ii)(B) and (a)(2)(ii)(C) of this section, for purposes of all applicable requirements regarding use and expenditure of proceeds of QZABs under section 1397E and this section, proceeds means "sale proceeds," as defined in §1.148–1(b), plus "investment proceeds," as defined in §1.148–1(b).

(B) *Private business contribution requirement.* For purposes of the private business contribution requirement of section 1397E(d)(2), proceeds means "sale proceeds," as defined in §1.148–1(b).

(C) *Arbitrage investment restrictions.* For purposes of the scope of application of the arbitrage investment restrictions under section 1397E(g) and paragraph (i) of this section, proceeds generally means gross proceeds, as defined in §1.148–1(b). In addition, in applying the arbitrage investment restrictions under paragraph (i) of this section and section 148, the various applicable definitions of the various types of proceeds of tax-exempt bonds under §1.148–1(b) shall apply.

(b) and (c) [Reserved]. For further guidance, see §1.1397E–1(b) and (c).

(d) *Maximum term.* The maximum term for a QZAB is determined under section 1397E(d)(3) by using a discount rate equal to 110 percent of the long-term adjusted applicable Federal rate (AFR), compounded semi-annually, for the month in which the bond is sold. The Internal Revenue Service publishes this figure each month in a revenue ruling that is published in the Internal Revenue Bulletin. See §601.601(d)(2)(ii)(*b*) of this chapter. A bond is sold on the sale date, as defined in §1.150–1(c)(6), which is the first day on which there is a binding contract in writing for the sale or exchange of the bond.

(e) through (g) [Reserved]. For further guidance, see §1.1397E–1(e) through (g).

(h) *Use of proceeds*—(1) *In general.* Section 1397E(d)(1) provides that a bond issued as part of an issue is a QZAB only if, among other requirements, at least 95 percent of the proceeds of the issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency (as defined in section 1397E(d)(4)(B)), and the issue meets the requirements of section 1397E(f) and (g). Section 1397E(d)(5) defines *qualified purpose*, with respect to any qualified zone academy, as rehabilitating or repairing the public school facility in which such academy is established, providing equipment for use at such academy, developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. Section 1397E(d)(4)(A) defines *qualified zone academy* as any public school (or academic program within a public school) that is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level and that meets the requirements of section 1397E(d)(4)(A)(i), (ii), (iii) and (iv).

(2) *Use of proceeds requirements.* An issue meets the requirements of sections 1397E(d)(1)(A) and (f) only if—

(i) The issuer reasonably expects, as of the issue date of the issue, that—

(A) At least 95 percent of the proceeds from the sale of the issue are to be spent for 1 or more qualified purposes with respect to qualified zone academies within the 5-year period beginning on the issue date of the QZAB;

(B) A binding commitment with a third party to spend at least 10 percent of the proceeds from the sale of the issue will be incurred within the 6-month period beginning on the issue date of the QZAB;

(C) At least 95 percent of the proceeds from the sale of the issue will be spent for a qualified purpose with respect to a qualified zone academy with due diligence (with due diligence measured by the reasonableness standard under §1.148–1(b); and

(D) At least 95 percent of the proceeds of the issue will be used for a qualified purpose with respect to a qualified zone academy for the entire term of the issue (without regard to any redemption provision); and

(ii) Except as otherwise provided in paragraph (h)(7) of this section, at least 95 percent of the proceeds of the issue are actually used for a qualified purpose with respect to a qualified academy for the entire term of the issue (without regard to any redemption provision).

(iii) *Extension of 5-year period.* The Commissioner may extend the period described in paragraph (h)(2)(i)(A) of this section if the issuer, prior to the end of such period, submits a private ruling request, and establishes to the satisfaction of the Commissioner that—

(A) The failure to satisfy the 5-year spending requirement is due to reasonable cause; and

(B) The expenditure of at least 95 percent of the proceeds from the sale of the issue for a qualified purpose with respect to a qualified zone academy will continue to proceed with due diligence.

(3) *Unspent proceeds.* For purposes of paragraphs (h)(2)(i)(D) and (h)(2)(ii) of this section, during the period described in paragraph (h)(2)(i)(A) of this section, including any extension under paragraph (h)(2)(iii) of this section, unspent proceeds are treated as used for a qualified purpose with respect to a qualified zone academy if the issuer reasonably expects to proceed with due diligence to spend those proceeds for a qualified purpose with respect to a qualified zone academy during that period.

(4) *Proceeds spent for rehabilitation, repair or equipment*—(i) *In general.* Under section 1397E(d)(5)(A), the term *qualified purpose* with respect to any qualified zone academy includes rehabilitating or repairing the public school facility in which such academy is established. For this purpose, in determining whether proceeds are spent for rehabilitation, rules similar to those under section 47(c) (other than sections 47(c)(1)(B) and 47(c)(2)(B)(iv)) shall apply. Under section 1397E(d)(5)(B), the term *qualified purpose* also includes providing equipment for use at such academy. If proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy,

then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure that—

(A) The property financed with those proceeds is used for the purposes of the academy; and

(B) The academy maintains its status as a qualified zone academy under section 1397E(d)(4).

(ii) *Retirement from service.* The retirement from service of financed property due to normal wear or obsolescence does not cause the property to fail to be used for a qualified purpose with respect to a qualified zone academy.

(5) *Proceeds spent to develop course materials or train teachers.* Section 1397E(d)(5)(C) and (D) provides that the term *qualified purpose* with respect to any qualified zone academy includes developing course materials for education to be provided at such academy, and training teachers and other school personnel in such academy. If proceeds of an issue are spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, then those proceeds are treated as used for a qualified purpose with respect to the academy during any period after such expenditure.

(6) *Special rule for determining status as qualified zone academy.* Section 1397E(d)(4)(A)(iv) provides that a public school (or academic program within a public school) is a qualified zone academy only if, among other requirements, the public school is located in an empowerment zone or enterprise community (as defined in section 1393), or there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act. For purposes of determining whether an issue complies with section 1397E(d)(4)(A)(iv)—

(i) A public school is treated as located in an empowerment zone or enterprise community for the entire term of the issue if the public school is located in an empowerment zone or enterprise community on the issue date of the issue; and

(ii) The determination of whether there is a reasonable expectation (as of the issue date of the issue) that at least 35 percent of the students attending the school or participating in the program (as the case may be) will be eligible for free or reduced-cost lunches under the school lunch program established under the Richard B. Russell National School Lunch Act is based on expectations regarding the one-year period following the issue date.

(7) *Remedial actions*—(i) *General rule.* If less than 95 percent of the proceeds of an issue are properly used (as determined under paragraph (h)(7)(ii)(D) of this section), the issue will be treated as meeting the requirements of section 1397E(d)(1)(A) if the issue met the requirements of paragraph (h)(2)(i) of this section and a remedial action is taken under paragraph (h)(7)(ii) or (iii) of this section.

(ii) *Redemption or defeasance*—(A) *In general.* A remedial action is taken under this paragraph (h)(7)(ii) if the requirements of paragraphs (h)(7)(ii)(B) and (C) of this section are met.

(B) *Retirement of nonqualified bonds*—*(1) In general.* The requirements of this paragraph (h)(7)(ii)(B) are met if—

(*i*) All of the nonqualified bonds of the issue (determined by applying the principles of §1.142–2(e)) are redeemed within 90 days after the date on which the failure to properly use proceeds occurs; or

(*ii*) To the extent of proceeds of the issue that have been actually spent for a qualified purpose with respect to a qualified zone academy, if any nonqualified bonds of the issue are not redeemed within 90 days after the date on which the failure to properly use such proceeds occurs (the unredeemed nonqualified bonds), a defeasance escrow is established for the unredeemed nonqualified bonds within 90 days after the date on which the failure to properly use proceeds occurs.

(*2*) *Special rule for dispositions for cash.* If the failure to properly use proceeds is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash, the requirements of this paragraph (h)(7)(ii)(B) are met if all of the disposition proceeds (as defined in paragraph (h)(7)(iv) of this section) are used within 90 days after the date of the disposition to redeem, or establish a defeasance escrow for, a *pro rata* portion of the nonqualified bonds of the issue.

(*3*) *Definition of defeasance escrow.* For purposes of this section, a defeasance escrow is an irrevocable escrow established to retire nonqualified bonds on the earliest call date after the date on which the failure to properly use proceeds occurs in an amount that is sufficient to retire nonqualified bonds on that call date. At least 90 percent of the weighted average amount in a defeasance escrow must be invested in investments (as defined in §1.148–1(b)), except that no amount in a defeasance escrow may be invested in any investment the obligor (or any person that is a related party with respect to the obligor within the meaning of §1.150–1(b)) of which is a user of proceeds of the bonds. All purchases or sales of an investment in a defeasance escrow must be made at the fair market value of the investment within the meaning of §1.148–5(d)(6).

(C) *Additional rules*—*(1) Limitation on source of funding.* Proceeds of an issue of QZABs (other than unspent proceeds of the issue for which the failure to properly use proceeds occurs) must not be used to redeem or defease nonqualified bonds under paragraph (h)(7)(ii)(B) of this section.

(*2*) *Rebate requirement.* The issuer must pay to the United States, at the same time and in the same manner as rebate amounts are required to be paid under §1.148–3 (or at such other time or in such other manner as the Commissioner may prescribe), any investment earnings on amounts in a defeasance escrow established under paragraph (h)(7)(ii)(B) of this section that are in excess of the yield on the issue of QZABs with respect to which the defeasance escrow was established. For this purpose, the first computation period begins on the date on which the defeasance escrow is established.

(*3*) *Notice of defeasance.* The issuer must provide written notice to the Commissioner, at the place designated in §1.150–5(a), of the establishment of the defeasance escrow within 90 days of the date the defeasance escrow is established.

(D) *When a failure to properly use proceeds occurs*—*(1) Unspent proceeds.* For unspent proceeds, a failure to properly use proceeds occurs on the earlier of—

(*i*) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy;

(*ii*) The first date on which the issuer fails to have a reasonable expectation to proceed with due diligence to spend at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy; or

(*iii*) The last day of the period described in paragraph (h)(2)(i)(A) of this section, including any extension, if less than 95 percent of the proceeds of the issue are actually spent for a qualified purpose with respect to a qualified zone academy.

(*2*) *Proceeds spent for rehabilitation, repair or equipment.* For proceeds that have been spent for a purpose described in section 1397E(d)(5)(A) or (B) with respect to a qualified zone academy, a failure to properly use proceeds occurs on the earlier of—

(*i*) The first date on which the public school (or academic program within the public school) fails to constitute a qualified zone academy; and

(*ii*) The first date on which an action is taken that causes the issuer to fail actually to use at least 95 percent of the proceeds of the issue for a qualified purpose with respect to a qualified zone academy.

(*3*) *Proceeds spent for course materials or training.* If proceeds have been spent for a purpose described in section 1397E(d)(5)(C) or (D) with respect to a qualified zone academy, no event subsequent to such expenditure shall constitute a failure to properly use such proceeds.

(iii) *Alternative use of disposition proceeds.* A remedial action is taken under this paragraph (h)(7)(iii) if all of the requirements of paragraphs (h)(7)(iii)(A) through (D) of this section are met—

(A) The failure to properly use proceeds (as determined under paragraph (h)(7)(ii)(D) of this section) is a disposition of financed property described in section 1397E(d)(5)(A) or (B) and the consideration for the disposition is exclusively cash;

(B) The issuer reasonably expects as of the date of the disposition that—

(*1*) All of the disposition proceeds will be spent within the two-year period beginning with the date of the disposition for a qualified purpose with respect to a qualified zone academy; or

(*2*) To the extent not expected to be so spent, the disposition proceeds will be used within 90 days after the date of the disposition to redeem or defease bonds in a manner that meets the requirements of paragraph (h)(7)(ii) of this section;

(C) The disposition proceeds are treated as proceeds for purposes of section 1397E; and

(D) If all of the disposition proceeds are not actually used in the manner described in paragraph (h)(7)(iii)(B) of this section, the remainder of such amounts are used within 90 days after the end of the period described in paragraph (h)(7)(iii)(B)(*1*) of this section for a remedial action that meets the requirements of paragraph (h)(7)(ii) of this section.

(iv) *Definition of disposition proceeds and allocation among multiple funding sources.* For purposes of this paragraph (h)(7), *disposition proceeds* means disposition proceeds, as defined in §1.141–12(c)(1), plus amounts derived from investing disposition proceeds. If property has been financed with an issue of QZABs and one or more other funding sources, any disposition proceeds from that property are allocated to the issue under the principles of §1.141–12(c)(3).

(8) *Payment of principal, interest or redemption price*—(i) *In general.* Except as provided in paragraphs (h)(8)(ii) and (h)(8)(iii) of this section, the use of proceeds of a bond to pay principal, interest, or redemption price of the bond or another bond is not a qualified purpose within the meaning of section 1397E(d)(5).

(ii) *Exception for certain eligible reimbursements of interim refinancings.* The use of proceeds of a bond (the refinancing bond) to pay principal, interest or redemption price of another bond (the prior bond) is a qualified purpose within the meaning of section 1397E(d)(5) to the extent that—

(A) The prior bond was not a QZAB (and, in the case of a series of refinancings, no earlier bond in the series was a QZAB);

(B) The proceeds of the prior bond (or the original bond in the case of a series of refinancings, as applicable) were spent for a qualified purpose under section 1397E(d)(5) (the original expenditure); and

(C) The issuer makes a valid reimbursement allocation to allocate the proceeds of the refinancing bond to the payment of the original expenditure (the reimbursement allocation), which allocation satisfies the requirements for reimbursements under paragraph (h)(9) of this section. For purposes of applying the rules for reimbursement, a refinancing bond which otherwise meets the requirements of this paragraph (h)(8)(ii) is eligible for reimbursement and is not treated as a disqualified refunding under §1.150–2(g).

(iii) *Reissuance of a QZAB.* For purposes of determining whether the establishing of a defeasance escrow under paragraph (h)(7)(ii)(B)(*1*)(*ii*) of this section results in an exchange under §1.1001–1(a), the QZAB is treated as a tax-exempt bond under §1.1001–3(e)(5)(ii)(B)(*1*).

(9) *Reimbursement.* An expenditure for a qualified purpose may be reimbursed with proceeds of a QZAB. For this purpose, rules similar to those on reimbursement of expenditures in §1.142–4(b) and §1.150–2 shall apply. In applying these reimbursement rules, expenditures eligible for reimbursement under §1.150–2(d)(3) shall be deemed to mean any expenditure for a qualified purpose under section 1397E(d)(5).

(i) *Arbitrage investment restrictions*—(1) *In general.* Under section 1397E(g) and this paragraph (i), and except as otherwise provided in this paragraph (i), the arbitrage investment restrictions and rebate requirements under section 148 and §1.148–1 to §1.148–11, inclusive, and the exceptions to those restrictions, apply broadly to gross proceeds of QZABs issued under section 1397E to the same extent and in the same manner as they apply to gross proceeds of tax-exempt state or local governmental bonds. For this purpose, references in those sections to tax-exempt bonds generally shall be deemed to refer to QZABs and, to the extent that any particular arbitrage restriction depends on whether bonds are private activity bonds under section 141, the determination of whether QZABs are private activity bonds shall be based on the general definition of private activity bonds under section 141. In applying section 148 and the regulations under that section to QZABs, the modifications set forth in paragraphs (i)(2) through (6) of this section shall apply.

(2) *5-year temporary period exception to arbitrage yield restriction.* If an issue of QZABs meets the requirements of section 1397E(f)(1) and paragraph (h)(2)(i) of this section, then the proceeds of the issue of QZABs are treated as qualifying for a 5-year temporary period exception to arbitrage yield restriction under

§1.148–2(e)(2) beginning on issue date of the issue.

(3) *Disregard QZAB credit in QZAB yield for arbitrage purposes.* In determining the yield on an issue of QZABs for arbitrage purposes under §1.148–4, the QZAB credit allowed under section 1397E(a) is disregarded.

(4) *Non-AMT tax-exempt bond investment exception inapplicable.* The exception to arbitrage yield restriction for investments of gross proceeds of tax-exempt bonds in specified tax-exempt bond investments not subject to section 148(b)(3)(B) (relating to an exception to the definition of "investment property" for specified tax-exempt bonds) and §1.148–2(d)(2)(v) (relating to a corresponding exception to arbitrage yield limitations) is inapplicable.

(5) *Application of small issuer exception to the arbitrage rebate requirement.* Except as otherwise provided in paragraph (i)(6) of this section, for purposes of the small issuer exception to the arbitrage rebate requirement under section 148(f)(4)(D) and §1.148–8, both QZABs and tax-exempt bonds (other than private activity bonds) that are actually issued or reasonably expected to be issued by the QZAB issuer (and applicable entities aggregated under section 148(f)(4)(D)) within a calendar year are taken into account in measuring the applicable size limitation.

(6) *Certain defeasance escrow earnings.* With respect to a defeasance escrow established in a remedial action for an issue of QZABs that meets the special rebate requirement under paragraph (h)(7)(ii)(C)(*2*) of this section, the QZAB issuer is treated as ineligible for the small issuer exception to arbitrage rebate under section 148(f)(4)(D) and paragraph (i)(5) of this section and compliance with that special rebate requirement is treated as satisfying applicable arbitrage investment restrictions under section 148 for that defeasance escrow.

(j) *Information reporting requirement.* Under section 1397E(h) and this paragraph (j), issuers of QZABs are required to submit information reporting returns to the IRS similar to the information reporting returns required to be submitted to the IRS under section 149(e) for tax-exempt state or local governmental bonds at the same time and in the same manner as those reports are required to be submitted to the IRS on such forms as shall be prescribed by the Commissioner for such purpose.

(k) and (l) [Reserved]. For further guidance, see §1.1397E–1(k) and (l).

(m) *Effective/applicability dates*—(1) *In general.* Except as otherwise provided in this paragraph (m), this section applies to bonds sold on or after September 14, 2007.

(2) *Special effective dates*—(i) *Effective dates for paragraphs (h)(2), (i), and (j) of this section in general.* Paragraphs (h)(2), (i), and (j) of this section apply to bonds issued pursuant to allocations of the national qualified zone academy bond volume cap authority for calendar years after 2005 and sold on or after September 14, 2007.

(ii) *Permissive retroactive application*—(A) *In general.* Except as otherwise provided in this paragraph (m), issuers and taxpayers may apply this section in whole, but not in part, to bonds sold before September 14, 2007.

(B) *Special rule for certain provisions.* For purposes of the permissive retroactive application rule in paragraph (m)(2)(ii)(A) of this section, paragraphs (h)(2), (i), and (j) of this section need not be applied to any bonds to which those provisions do not otherwise apply under the general effective date provisions for those provisions in paragraph (m)(2)(i) of this section.

(C) *Definition of proceeds.* Issuers and taxpayers may apply paragraphs (d) and (h) of this section, without regard to the definition of proceeds in paragraph (a)(2)(ii) of this section, to bonds sold before September 14, 2007.

(D) *Bonds issued before July 1, 1999.* Paragraphs (d) and (h)(9) of this section may not be applied to bonds issued before July 1, 1999.

(3) *Expiration date.* The applicability of this section expires on or before July 13, 2010.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1397E–1T	1545–1908
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

Approved July 3, 2007.

(Filed by the Office of the Federal Register on July 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 16, 2007, 72 F.R. 38767)

Section 1502.—Regulations

26 CFR 1.1502–19: Excess loss accounts.

T.D. 9341

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Treatment of Excess Loss Accounts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 1502. Section 1.1502–19(d) governs basis determinations and adjustments of subsidiary stock in certain transactions involving members of a consolidated group. Section 1.1502–80(c) governs the determination of when subsidiary stock is treated as worthless under section 165. These final regulations affect affiliated groups of corporations filing consolidated returns.

DATES: *Effective Date:* These final regulations are effective on July 18, 2007.

Applicability Dates: Section 1.1502–19(d) applies to transactions occurring on or after July 18, 2007. Section 1.1502–80(c) applies to taxable years for which the original consolidated Federal income tax return is due (without extensions) after July 18, 2007.

FOR FURTHER INFORMATION CONTACT: For questions regarding §1.1502–19(d), contact Theresa M. Kolish, (202) 622–7530 (not a toll-free number). For questions regarding §1.1502–80(c), contact Theresa Abell, (202) 622–7700 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 26, 2006, the IRS and Treasury Department published a notice of proposed rulemaking (REG–138879–05, 2006–1 C.B. 503 [71 FR 4319]) by cross-reference to a temporary regulation under §1.1502–19 (T.D. 9244, 2006–1 C.B. 463 [71 FR 4264]). Prior to the publication of the proposed and temporary regulations, the direction of a transaction determined whether an excess loss account would be reduced or eliminated. For example, if P had owned all the stock of S with an excess loss account of $100 and all of the stock of T with a basis of $150, and T had merged into S in a reorganization described in section 368(a)(1)(D) in which P received additional shares of S stock, under §1.1502–19(d), P's excess loss account in its original shares of S stock was first eliminated. Therefore, P's original S shares would have had an aggregate basis of $0 and P's new S shares would have had an aggregate basis of $50. However, if S instead had merged into T in a reorganization described in section 368(a)(1)(D) in which P received additional shares of T stock, §1.1502–19(d) would not have applied because P did not already have T shares with an excess loss account. Therefore, P's original T shares would have had a basis of $150 and P's new T shares would have had an excess loss account of $100.

The IRS and Treasury Department found the electivity of the rule based on the direction of the transaction to be undesirable. Accordingly, the IRS and Treasury Department added §1.1502–19T(d), which provides that, if a member would otherwise determine shares of a class of S's stock (a new share) to have an excess loss account and such member owns one or more other shares of the same class of S's stock, the basis of such other shares is allocated to eliminate and equalize any excess loss account that would otherwise be in the new shares.

No public hearing regarding the proposed regulation was requested or held. However, a few informal comments regarding the proposed and temporary regulations were received. In particular, the commentators noted that §1.1502–19T(d) would appear to apply in the earlier example if P had excess loss accounts in its shares of both S and T. For example, assume that P owned S and T (which were of equal value), P had a $50 excess loss account in its S stock and a $100 excess loss account in its T stock, and T merged into S in a reorganization described in section 368(a)(1)(D) in which additional shares were issued. Under §1.1502–19T(d), the excess loss accounts in the two blocks of S stock would be equalized so that P would have a $75 excess loss account in each block. The commentators asked whether this outcome was intended. The IRS and Treasury Department believe that the excess loss accounts in this example should be equalized and affirm that §1.1502–19 does apply under the facts presented. This application eliminates the disparity between excess loss accounts in order to better reflect P's investment in its subsidiary stock. The proposed regulation under §1.1502–19 is adopted by this Treasury decision and the temporary regulation is removed.

Additionally, on January 23, 2007, the IRS and Treasury Department published a notice of proposed rulemaking (REG–157711–02, 2007–8 I.R.B. 537 [72 FR 2964]) under §1.1502–80(c) regarding when the stock of a member is treated as worthless under section 165. The proposed regulation is adopted without substantive modification by this Treasury Decision, and is applicable to tax years for which the original consolidated Federal income tax return is due (without extensions) after July 18, 2007. Section 1.1502–80T is removed.

Consistent with the prior final regulations, these regulations provide that subsidiary stock is not treated as worthless before the earlier of the time that the subsidiary ceases to be a member of the group or the time that the stock of the subsidiary is worthless within the meaning of §1.1502–19(c)(1)(iii). Section 1.1502–19(c)(1)(iii) identifies three separate events that cause a share of subsidiary stock to be treated as worthless and therefore disposed of for purposes of taking into account an excess loss account in the share. Section 1.1502–19(c)(1)(iii)(A) applies when the subsidiary disposes of substantially all of its assets, and the deferral of any worthless securities deduction until that time implements single-entity principles. While an event identified in either §1.1502–19(c)(1)(iii)(B) or (C) (generally dealing with debt cancellations) will likely occur in connection with an event identified in §1.1502–19(c)(1)(iii)(A), either may occur independently. In light of the single-entity purpose of the regulations, the IRS and Treasury Department are requesting comments regarding whether

these regulations should refer only to the time stock is treated as worthless within the meaning of §1.1502–19(c)(1)(iii)(A).

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to 5 U.S.C. 553(d)(3) it has been determined that a delayed effective date is unnecessary because this rule finalizes currently effective temporary rules regarding the treatment of excess loss accounts without substantive change. It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Moreover, the number of taxpayers affected and the average burden are minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notices of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of §1.1502–19 is Theresa M. Kolish of the Office of the Associate Chief Counsel (Corporate), IRS. The principal author of §1.1502–80(c) is Theresa Abell of the Office of the Associate Chief Counsel (Corporate), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.1502–19T and 1.1502–80T to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–19 and §1.1502–80 are also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502–19 is amended by revising paragraphs (d), (g) and (h)(2)(iv) to read as follows:

§1.1502–19 Excess loss accounts.

* * * * *

(d) *Special allocation of basis in connection with an adjustment or determination*—(1) *Excess loss account in original shares.* If a member has an excess loss account in shares of a class of S's stock at the time of a basis adjustment or determination under the Internal Revenue Code with respect to shares of the same class of S's stock owned by the member, the adjustment or determination is allocated first to equalize and eliminate that member's excess loss account. See §1.1502–32(c) for similar allocations of investment adjustments to prevent or eliminate excess loss accounts.

(2) *Excess loss account in new S shares.* If a member would otherwise determine shares of a class of S's stock (new shares) to have an excess loss account and such member owns one or more other shares of the same class of S's stock, the basis of such other shares is allocated to eliminate and equalize any excess loss account that would otherwise be in the new shares.

* * * * *

(g) * * *

Example 2. Basis determinations under the Internal Revenue Code in intercompany reorganizations—transfer of shares without an excess loss account. (i) *Facts.* P owns all of the sole class of stock of each of S and T. P has 150 shares of S stock that it acquired on Date 1. Each S share has a $1 basis and a fair market value of $1. P has 100 shares of T stock that it acquired on Date 2. Each T share has a $1.20 excess loss account and a fair market value of $1. P transfers S's stock to T without receiving additional T stock. The transfer is an exchange described in both section 351 and section 354.

(ii) *Analysis.* Under sections 351 and 354, P does not recognize gain in connection with the transfer. Under §1.358–2(a)(2)(iii), P is deemed to receive 150 shares of T stock of the same class. Without regard to the application of paragraph (d) of this section, under section 358 and §1.358–2(a)(2)(i), P would have a $1 basis in each such share. However, because the basis of the additional shares of T stock will be determined when P has an excess loss account in its original shares of T stock, under paragraph (d)(1) of this section, the basis that P would otherwise have in such additional shares will eliminate the excess loss account in P's original shares of T stock such that each original share of T stock will have a basis of $0 and each share of T stock deemed received will have a basis of $0.20. Then, under §1.358–2(a)(2)(iii), the T stock is deemed to be recapitalized in a reorganization under section 368(a)(1)(E) in which P receives 100 shares of T stock (those shares P actually owns immediately after the transfer) in exchange for those 100 shares of T stock that P held immediately prior to the transfer and those 150 shares of T stock P is deemed to receive in the transfer. Under §1.358–2(a)(2)(i), immediately after the transfer, P holds 100 shares of T stock, 60 of which take a basis of $0.50 each and 40 of which take a basis of $0 each. In addition, T takes a $1 basis in each share of S stock under section 362. (If P had actually received an additional 150 shares of T stock of the same class, paragraph (d)(1) of this section would apply to shift basis from such additional T shares to P's original T shares because the basis of the additional T stock would be determined when P had an excess loss account in its original T shares. P would have a basis of $0 in each of the original T shares and a basis of $0.20 in each of the additional T shares.)

(iii) *Transfer of shares with an excess loss account.* The facts are the same as in paragraph (i) of this *Example 2*, except that P transfers T's stock to S without receiving additional S stock. The transfer is an exchange described in both section 351 and section 354. Under paragraph (c) of this section, P's transfer is treated as a disposition of T's stock. Under sections 351 and 354 and paragraph (b)(2) of this section, P does not recognize gain from the disposition. Under §1.358–2(a)(2)(iii), P is deemed to have received 100 shares of S stock of the same class. Without regard to the application of paragraph (d) of this section, P would have a $1.20 excess loss account in each such share. However, because P will have an excess loss account in such shares and P owns other shares of S stock of the same class, under paragraph (d)(2) of this section, the excess loss account that P would otherwise have in such shares will decrease P's basis in its original shares of S's stock such that each such original share will have a basis of $0.20 and each share deemed received will have a basis of $0. Then, under §1.358–2(a)(2)(iii), the S stock is deemed to be recapitalized in a reorganization under section 368(a)(1)(E) in which P receives 150 shares of S stock (those shares P actually owns immediately after the transfer) in exchange for those 150 shares of S stock that P held immediately prior to the transfer and those 100 shares of S stock that P is deemed to receive in connection with the transfer. Under §1.358–2(a)(2)(i), immediately after the transfer, P holds 150 shares of S stock, 90 of which take a basis of $0.33 each and 60 of which take a basis of $0 each. In addition, S takes an excess loss account of $1.20 in each share of T stock under section 362. (If P had actually received 100 additional shares of S stock of the same class, paragraph (d)(2) of this section would apply to shift basis from P's original S stock because P would have otherwise had an excess loss account in such additional shares and P owned other shares of S stock of the same class. The excess

loss account that P would have otherwise had in such additional shares would have decreased P's basis in its original shares of S's stock. P would have had a basis of $0.20 in each of the original shares and a basis of $0 in each of the additional shares.)

(iv) *Intercompany merger—shares with excess loss account retained.* The facts are the same as in paragraph (i) of this *Example 2*, except that S merges into T in a reorganization described in section 368(a)(1)(A) (and in section 368(a)(1)(D)), and P receives 150 additional shares of T stock of the same class in the reorganization. Under section 354, P does not recognize gain. Without regard to the application of paragraph (d) of this section, under section 358 and §1.358–2(a)(2)(i), P would have a $1 basis in each such share. However, because the basis of the additional shares of T stock will be determined when P has an excess loss account in its original shares of T stock, under paragraph (d)(1) of this section, the basis that P would otherwise have in such additional shares eliminates the excess loss account in P's original shares of T stock such that each original share of T stock has a basis of $0 and each additional share of T stock has a basis of $0.20.

(v) *Intercompany merger—shares with excess loss account surrendered.* The facts are the same as in paragraph (i) of this *Example 2*, except that T merges into S in a reorganization described in section 368(a)(1)(A) (and in section 368(a)(1)(D)), and P receives 100 additional shares of S stock of the same class in the reorganization. Under section 354 and paragraph (b)(2) of this section, P does not recognize gain from the disposition. Without regard to the application of paragraph (d) of this section, under section 358 and §1.358–2(a)(2)(i), P would have a $1.20 excess loss account in each additional share of S stock received. However, because P would have an excess loss account in such shares and P owns other shares of S stock of the same class, under paragraph (d)(2) of this section, the excess loss account that P would otherwise have in such shares decreases P's basis in its original shares of S's stock such that each original share of S stock has a basis of $0.20 and each additional share of S stock has a basis of $0.

* * * * *

(h) * * *

(2)(iv) *Intercompany reorganizations.* Paragraphs (d) and (g) *Example 2* of this section apply to transactions occurring on or after July 18, 2007. For transactions occurring on or after January 23, 2006, and before July 18, 2007, see §1.1502–19T as contained in 26 CFR part 1 in effect April 1, 2007. For transactions occurring before January 23, 2006, see §1.1502–19 as contained in 26 CFR part 1 in effect April 1, 2005.

* * * * *

§1.1502–19T [Removed]

Par. 3. Section 1.1502–19T is removed.

Par. 4. Section 1.1502–80 is amended by revising paragraph (c) to read as follows:

§1.1502–80 Applicability of other provisions of law.

* * * * *

(c) *Deferral of section 165*—(1) *General rule.* Subsidiary stock is not treated as worthless under section 165 until immediately before the earlier of the time—

(i) The stock is worthless within the meaning of §1.1502–19(c)(1)(iii); or

(ii) The subsidiary for any reason ceases to be a member of the group.

(2) *Cross reference.* See §§1.337(d)–2 and 1.1502–35 for additional rules relating to loss on subsidiary stock.

(3) *Effective/applicability date.* This paragraph (c) applies to taxable years for which the original consolidated Federal income tax return is due (without extensions) after July 18, 2007. However, taxpayers may apply this paragraph (c) to taxable years beginning on or after January 1, 1995.

* * * * *

§1.1502–80T [Removed]

Par. 5. Section 1.1502–80T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 10, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 17, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2007, 72 F.R. 39313)

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26 CFR 1.1502–47: Consolidated returns by life-nonlife groups.

T.D. 9342

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Under Section 1502; Amendment of Tacking Rule Requirements of Life-Nonlife Consolidated Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 1502 concerning the requirements for including insurance companies in a life-nonlife consolidated return. These regulations conform the consolidated return rules to certain changes in law. These regulations affect corporations filing life-nonlife consolidated returns.

DATES: *Effective Date:* These regulations are effective July 20, 2007.

Applicability Date: For dates of applicability, see §§1.1502–47(b) and 1.1502–76(d).

FOR FURTHER INFORMATION CONTACT: Ross Poulsen (202) 622–7790 or Marcie Barese (202) 622–7790 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 1504(c) of the Internal Revenue Code permits life companies to join in the filing of a consolidated return with nonlife corporations with certain restrictions, the principal one of which is that a life company must be a member of the affiliated group (without regard to section 1504(b)(2)) for five taxable years before it may join in the filing of the consolidated group's return. Section 1.1502–47 contains an exception to this requirement (the tacking rule) for transactions that meet certain conditions. The original tacking rule contained five conditions, including "the separation condition."

Before 1981, section 843 required all insurance companies taxed under Subchapter L to adopt a calendar year tax year. The consolidated return regulations required all members of a consolidated group to adopt the tax year of the common parent, but, in order to accommodate section 843, required a fiscal-year consolidated group to change its tax year to a

calendar year if, on the last day of its fiscal year, it included an insurance company required by section 843 to use a calendar year (Old §1.1502–76(a)(2)). In 1981, an amendment to section 843 became effective, providing that, under regulations prescribed by the Secretary, an insurance company joining in the filing of a consolidated return may adopt the fiscal year of the common parent corporation.

On April 25, 2006, temporary regulations (T.D. 9258, 2006–1 C.B. 886) were published in the **Federal Register** (71 FR 23856) amending the tacking rule of the life-nonlife consolidated return regulations and the regulations relating to taxable years of members of a consolidated group. A notice of proposed rulemaking (REG–133036–05, 2006–1 C.B. 911) cross-referencing those temporary regulations was published in the **Federal Register** (71 FR 23882) on the same day. The temporary regulations removed the separation condition of the tacking rule and Old §1.1502–76(a)(2).

On May 30, 2006, temporary regulations (T.D. 9264, 2006–1 C.B. 1150) were published in the **Federal Register** (71 FR 30591), in part, amending the regulations relating to taxable years of members of a consolidated group. A notice of proposed rulemaking (REG–134317–05, 2006–1 C.B. 1184) cross-referencing those temporary regulations was published in the **Federal Register** (71 FR 30640) on the same day. The temporary regulations eliminated impediments to the electronic filing of the statement made under §1.1502–76(b)(2)(ii).

The IRS and Treasury Department considered several comments responding to the proposed and temporary regulations. After consideration of these comments, the final regulations adopt the provisions of the proposed regulations without substantive change and the corresponding temporary regulations are removed.

Explanation and Summary of Comments

Effective Date of §1.1502–47

The IRS received two comments from the public relating to the effective date of Prop. Reg. §1.1502–47 and Temp. Reg. §1.1502–47T. The proposed and temporary regulations are effective for taxable years for which the due date (without extensions) for filing returns is after April 25, 2006, (their date of publication). Several commentators noted that the preamble to the temporary regulations indicated that the purpose of the separation condition was largely eliminated in 1984 after Congress repealed the three phase system of life insurance company taxation, and it became even less relevant after Congress suspended taxation on distributions from policyholders surplus accounts made during 2005 and 2006. On that basis, these commentators requested that the effective date of the final regulations be applicable retroactively for all open tax years. While making this request, however, the commentators recognized that retroactive application of the regulations would present serious administrative concerns. The IRS and Treasury Department agree with the commentators that retroactive application of the final regulations raises significant questions of administrability. Therefore, in the interest of sound tax administration, the IRS and Treasury Department decline to adopt this suggestion.

Alternatively, the commentators requested that these final regulations be applicable for returns due after the effective date of the temporary regulations. We agree with this suggestion. Accordingly, the temporary regulations are applicable to returns due (without extensions) after April 25, 2006, and on or before the effective date of these final regulations. These final regulations are applicable to returns due (without extensions) after their effective date.

Comments on Prop. Reg. §1.1502–76 and Temp. Reg. §1.1502–76T

One commentator raised several concerns with the proposal to remove Old §1.1502–76(a)(2). First, the commentator reads both the language of section 843 and the legislative history of the amendment to section 843 as demonstrating congressional intent to create a choice, when an insurance company joins a fiscal-year consolidated group, of whether the group remains on the fiscal year (requiring the joining insurance member to adopt the fiscal year) or adopts a calendar year tax year. Amended section 843 provides that (under regulations) an insurance company joining in the filing of a consolidated return "may adopt" the taxable year of the common parent corporation. The legislative history of amended section 843 acknowledges that "[s]ome life companies may not want to adopt a [fiscal] year. . . ." S. Rep. No. 94–938, at 455–56 (1976).

The IRS and Treasury Department do not agree with the commentator's interpretation of the statute or the legislative history. The election discussed in the legislative history is the election under section 1504(c) allowing a life company to join in the consolidated return of a nonlife group. The legislative history notes that "[i]f this election is not made, existing law will continue to apply." The legislative history goes on to state:

> It is understood that although generally companies will probably desire to file consolidated returns with the life or other mutual insurance companies, some may choose to continue to file separate returns under existing law. Where this occurs, it is likely to arise from the fact that the parent corporation (whose year the other members joining in the filing of the consolidated return must follow) uses a fiscal year as its taxable year. Some life companies may not want to adopt a taxable year other than a calendar year since filings with State insurance commissioners are required by these life companies on a calendar year basis.

S. Rep. No. 94–938, at 455–56 (1976).

Rather than suggesting that the group has an election to change its taxable year when a newly-joining life company does not desire to adopt the group's fiscal year, the legislative history suggests that Congress expected, in such cases, that no section 1504(c) election would be made and the life company would continue filing separately. Further, the legislative history is clear that Congress amended section 843 in order to accommodate the consolidated return rules relating to taxable years of members of consolidated groups, not to modify or override them.

The sole purpose of Old §1.1502–76(a)(2) was to conform the consolidated rules to section 843. Once section 843 was amended, not only was the purpose of Old §1.1502–76(a)(2) eliminated, but Old §1.1502–76(a)(2) was no longer operative because it only applies to groups with "an includible insurance company required by section 843 to file its return on the basis of

a calendar year . . . ." For these reasons, the IRS and Treasury Department decline to create a regulatory election allowing fiscal-year consolidated groups to switch to a calendar year upon including an insurance company in its consolidated group.

Another comment noted that the legislative history of the amendment to section 843 contemplates that the Secretary will write regulations that require insurance companies adopting the fiscal year of a consolidated group to maintain adequate records reconciling all of the items on its fiscal year tax return with the corresponding items on its calendar year statements filed with State insurance commissioners. Since the amendment to section 843, the input received by the IRS and Treasury Department from taxpayers has not suggested a need for guidance in this area. However, the IRS and Treasury Department welcome comments on this topic.

The final comment suggested that a rule be added allowing an insurance company that joins a fiscal-year consolidated group and leaves the group before the end of the group's tax year to maintain its calendar year. The comment observed that, without such a rule, §1.1502–76T(a) and section 843 create unnecessary work for such an insurance company because upon joining the group, the insurance company would be required to adopt the common parent's fiscal year under §1.1502–76T(a)(1) and upon leaving the group, the insurance company would have to readopt a calendar year under section 843.

The IRS and Treasury Department decline to adopt this suggestion because they believe that the number of taxpayers affected by such a scenario would be too minimal to justify the creation of a special rule.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to 5 U.S.C. 553(d)(3) it has been determined that a delayed effective date is unnecessary because this rule finalizes currently effective temporary rules regarding including life insurance companies in a life-nonlife consolidated return. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect affiliated groups of corporations with one or more life insurance company members, which tend to be larger businesses. Moreover, the number of taxpayers affected is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Marcie Barese, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.1502–47T and 1.1502–76T to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–47 also issued under 26 U.S.C. 1502, 1503(c) and 1504(c). * * *

Par. 2. Section 1.1502–47 is amended by revising paragraphs (b)(2) and (d)(12)(v).

The revisions read as follows:

§1.1502–47 Consolidated returns by life-nonlife groups.

* * * * *

(b) * * *

(2) *Tacking rule effective dates.* (i) *In general.* Paragraph (d)(12)(v) of this section applies to any original consolidated Federal income tax return due (without extensions) after July 20, 2007.

(ii) *Prior law.* For original consolidated Federal income tax returns due (without extensions) after April 25, 2006, and on or before July 20, 2007, see §1.1502–47T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before April 25, 2006, see §1.1502–47 as contained in 26 CFR part 1 in effect on April 1, 2006.

* * * * *

(d) * * *

(12) * * *

(v) *Tacking rule.* The period during which an old corporation is in existence and a member of the group engaged in active business is included in (or tacks onto) the period for the new corporation if the following four conditions listed in this paragraph (d)(12)(v) are met. For purposes of this paragraph (d)(12)(v), a new corporation is a corporation (whether or not newly organized) during the period its eligibility depends upon the tacking rule. The four conditions are as follows—

(A) The first condition is that, at any time, 80 percent or more of the new corporation's assets it acquired (other than in the ordinary course of its trade or business) were acquired from the old corporation in one or more transactions described in section 351(a) or 381(a). This asset test is applied by using the fair market values of assets on the date they were acquired and without regard to liabilities. Assets acquired in the ordinary course of business will be excluded from total assets only if they were acquired after the new corporation became a member of the group (determined without section 1504(b)(2)). In addition, assets that the old corporation acquired from outside the group in transactions not conducted in the ordinary course of its trade or business are not included in the 80 percent (but are included in total assets) if the old corporation acquired those assets within five calendar years before the date of their transfer to the new corporation.

(B) The second condition is that at the end of the taxable year during which the first condition is first met, the old corporation and the new corporation must both have the same tax character. For purposes of this paragraph (d)(12), a corporation's tax character is the section under which it would be taxed (*i.e.*, sections 11, 802,

821, or 831) if it filed a separate return. If the old corporation is not in existence (or adopts a plan of complete liquidation) at the end of that taxable year, this paragraph (d)(12)(v)(B) will apply to the old corporation's taxable year immediately preceding the beginning of the taxable year during which the first condition is first met.

(C) The third condition is that, at the end of the taxable year during which the first condition is first met, the new corporation does not undergo a disproportionate asset acquisition under paragraph (d)(12)(viii) of this section.

(D) The fourth condition is that, if there is more than one old corporation, the first two conditions apply to all of the corporations. Thus, the second condition (tax character) must be met by all of the old corporations transferring assets taken into account in meeting the test in paragraph (d)(12)(v)(A) of this section.

* * * * *

§1.1502–47T [Removed]

Par. 3. Section 1.1502–47T is removed.

Par. 4. Section 1.1502–76 is amended by revising paragraphs (a), (b)(2)(ii)(D), and (d).

The revisions read as follows:

§1.1502–76 Taxable year of members of group.

(a) *Taxable year of members of group.* The consolidated return of a group must be filed on the basis of the common parent's taxable year, and each subsidiary must adopt the common parent's annual accounting period for the first consolidated return year for which the subsidiary's income is includible in the consolidated return. If any member is on a 52-53-week taxable year, the rule of the preceding sentence shall, with the advance consent of the Commissioner, be deemed satisfied if the taxable years of all members of the group end within the same 7-day period. Any request for such consent shall be filed with the Commissioner of Internal Revenue, Washington, DC 20224, not later than the 30th day before the due date (not including extensions of time) for the filing of the consolidated return.

(b) * * *

(2) * * *

(ii) * * *

(D) *Election—(1) Statement.* The election to ratably allocate items under this paragraph (b)(2)(ii) must be made in a separate statement entitled, "THIS IS AN ELECTION UNDER §1.1502–76(b)(2)(ii) TO RATABLY ALLOCATE THE YEAR'S ITEMS OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF THE MEMBER]." The election must be filed by including a statement on or with the returns including the items for the years ending and beginning with S's change in status. If two or more members of the same consolidated group, as a consequence of the same plan or arrangement, cease to be members of that group and remain affiliated as members of another consolidated group, an election under this paragraph (b)(2)(ii)(D)(*1*) may be made only if it is made by each such member. Each statement must also indicate that an agreement, as described in paragraph (b)(2)(ii)(D)(*2*) of this section, has been entered into. Each party signing the agreement must retain either the original or a copy of the agreement as part of its records. See §1.6001–1(e).

(*2*) *Agreement.* For each election under this paragraph (b)(2)(ii), the member and the common parent of each affected group must sign and date an agreement. The agreement must—

(*i*) Identify the extraordinary items, their amounts, and the separate or consolidated returns in which they are included;

(*ii*) Identify the aggregate amount to be ratably allocated, and the portion of the amount included in the separate and consolidated returns; and

(*iii*) Include the name and employer identification number of the common parent (if any) of each group that must take the items into account.

* * * * *

(d) *Effective/applicability date*—(1) *Taxable years of members of group effective date.* (i) *In general.* Paragraph (a) of this section applies to any original consolidated Federal income tax return due (without extensions) after July 20, 2007.

(ii) *Prior law.* For original consolidated Federal income tax returns due (without extensions) after April 25, 2006, and on or before July 20, 2007, see §1.1502–76T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before April 25, 2006, see §1.1502–76 as contained in 26 CFR part 1 in effect on April 1, 2006.

(2) *Election to ratably allocate items effective date.* (i) *In general.* Paragraph (b)(2)(ii)(D) of this section applies to any original consolidated Federal income tax return due (without extensions) after July 20, 2007.

(ii) *Prior law.* For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before July 20, 2007, see §1.1502–76T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–76 as contained in 26 CFR part 1 in effect on April 1, 2006.

§1.1502–76T [Removed]

Par. 5. Section 1.1502–76T is removed.

Par. 6. For each entry in the "Location" column of the following table, remove the language in the "Remove" column and add the language in the "Add" column in its place:

Location	Remove	Add
§1.1502–35(c)(4)(ii)(B)	§1.1502–76T(b)(2)(ii)(D)	§1.1502–76(b)(2)(ii)(D)
§1.1502–76(b)(2)(ii)(A)(2)	paragraph (b)(2)(ii)(D) of §1.1502–76T	paragraph (b)(2)(ii)(D) of this section

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 16, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39734)

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(f)(2)–1: Withholding exemption certificates.

T.D. 9337

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 31

Withholding Exemptions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations providing guidance under section 3402(f) of the Internal Revenue Code (Code) for employers and employees relating to the Form W–4, "*Employee's Withholding Allowance Certificate*." The regulations provide rules for income tax withholding when the IRS notifies the employer and the employee of the maximum number of withholding exemptions permitted. The regulations also provide rules for the use of substitute forms and preserve the IRS's ability to require the submission of certain copies of withholding exemption certificates. The regulations primarily affect taxpayers who are employers and employees.

DATES: *Effective Date:* These regulations are effective July 13, 2007.

Applicability Date: Except as provided in section 31.3402(f)(2)–1(g)(5), section 31.3402(f)(2)–1(g) applies on April 14, 2005. Section 31.3402(f)(2)–1(g)(2)(iii)(A), (B), and (C) and section 31.3402(f)(2)–1(g)(2)(ix) apply on October 11, 2007, except taxpayers may rely on such paragraphs for notices issued prior to such date. Section 31.3402(f)(5)–1(a)(1) applies on April 14, 2005. Section 31.3402(f)(5)–1(a)(2) applies October 11, 2007.

FOR FURTHER INFORMATION CONTACT: Ilya Enkishev, (202) 622–0047 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations do not impose any new information collection. The Office of Management and Budget (OMB) previously approved the information collection requirements concerning Form W–4 contained in the regulations under section 6001 (§31.6001–5; OMB Control No. 1545–0798) and in the regulations under section 3402 (§31.3402(f)(2)–1; OMB Control No. 1545–0010) under the provisions of the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.* Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 3402(f)(2)(A) of the Internal Revenue Code, every employee is required to furnish his or her employer with a signed withholding exemption certificate on or before commencing employment. The regulations prescribe the form of the certificate as the Form W–4. The maximum number of withholding exemptions to which an employee is entitled depends upon the employee's marital status, the employee's filing status, the number of the employee's dependents, the number of exemptions claimed by the employee's spouse (if any) on a Form W–4, and the amount of the employee's estimated itemized deductions, tax credits, and certain other deductions from income.

For many years, the regulations under section 3402(f) required employers to submit to the IRS a copy of each Form W–4 on which an employee claimed more than a certain number of withholding exemptions. Employers had to also submit a copy of each Form W–4 on which the employee claimed a complete exemption from withholding for the taxable year if the employer reasonably expected, when the Form W–4 was received, that the employee's wages from that employer would usually be $200 or more per week. The regulations also provided that the IRS could notify an employer that a named employee was not entitled to claim a complete exemption from withholding and was not entitled to claim more withholding exemptions than the number specified by the IRS in the notice. The IRS issued this notice (often called a "lock-in letter") if the IRS found that the withholding exemption certificate contained a materially incorrect statement or if the IRS found, after written request to the employee for verification of the statements on the certificate, that the IRS lacked sufficient information to determine if the certificate was correct. In these cases, the employer was required to withhold tax based on the number of withholding exemptions specified in the notice from the IRS unless otherwise notified by the IRS.

On April 14, 2005, the Department of Treasury published temporary regulations (T.D. 9196, 2005–1 C.B. 1000) in the **Federal Register** (70 FR 19694) under section 3402(f) modifying the rules relating to the submission of Forms W–4 and relating to the IRS' notification of the number of withholding exemptions permitted. The Department of Treasury also published a notice of proposed rulemaking (REG–162813–04, 2005–1 C.B. 1010) cross-referencing the temporary regulations in the **Federal Register** on the same day.

Effective when published, the temporary regulations changed the procedures for submitting copies of Forms W–4 to the IRS. Specifically, under the temporary regulations employers were no longer routinely required to submit a copy of any Form W–4 on which an employee claimed more than 10 withholding exemptions. In addition, employers were no longer routinely required to submit a copy of any Form W–4 on which an employee claimed complete exemption from withholding for the taxable year if the employer reasonably expected, when the Form W–4 was received, that the employee's wages from

that employer would usually be $200 or more per week. Rather, the temporary regulations provided that employers must submit copies of Forms W–4 only if instructed to do so in published guidance or in a written notice to the employer from the IRS. At this time, the IRS has not issued any published guidance requiring the submission of Forms W–4 to the IRS.

The temporary regulations authorized the IRS to issue a notice to an employer specifying the maximum withholding exemptions permitted to be claimed by the employee without first obtaining a copy of the withholding exemption certificate from the employer. Under the temporary regulations, the IRS issued this notice to the employer with a copy for the employee. The IRS also sent another copy to the employee at the employee's last known address. The temporary regulations provided that the employer must withhold tax in accordance with the notice as of the date specified in the notice, which was required to be at least 45 calendar days after the date of the notice. If the employee wanted to claim complete exemption from withholding or claim more withholding exemptions than the number specified by the IRS in the notice, the employee must contact the IRS to provide information to support the claim. The previous, and now obsolete, regulations permitted the employee to send this information to the employer to forward to the IRS. To reduce burdens on employers and to facilitate efficient responses to the employee, the temporary regulations required the employee to contact the IRS directly.

Finally, the temporary regulations also permitted employers to give their employees a substitute withholding exemption certificate, if the employers also gave them the worksheets contained in the Form W–4 in effect at that time. The temporary regulations also authorized employers to refuse to accept a substitute form developed by an employee.

The proposed regulations were identical to the temporary regulations described in the Preamble. The publication of the proposed and temporary regulations followed a comprehensive review of withholding compliance, which found that withholding noncompliance remained a problem with some employees. In connection with the publication of the proposed and temporary regulations, the IRS developed a process to use information already reported on Forms W–2, *Wage and Tax Statements*, to more effectively identify and address employees with withholding compliance problems.

A public hearing on the proposed regulations was held on July 26, 2005. Written and electronic comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the Department of Treasury adopts the proposed regulations, as modified herein, as final regulations, and removes the corresponding temporary regulations.

Summary of Comments and Explanation of Provisions

The publication of this Treasury decision follows the implementation of the IRS's new process for using information already reported on Forms W–2 to more effectively identify employees with withholding compliance problems. The modifications to the proposed regulations that are included in these final regulations reflect both consideration of the comments submitted by taxpayers and changes needed following the implementation of the new process.

The comments received were generally favorable to the changes proposed by the proposed regulations and implemented by the temporary regulations. Commentators observed that the regulations reduced burdens on employers by eliminating the requirement that employers submit questionable Forms W–4 to the IRS and the requirement that employers transmit communications from the employee to the IRS. One commentator recommended that, as an alternative to the withholding compliance program, the problem of underwithholding should be addressed by increasing the employee's estimated tax penalty if insufficient taxes are withheld and otherwise paid by the employee for the year. While tax penalties do deter some employees from submitting Forms W–4 claiming excessive withholding exemptions, the IRS has concluded that the withholding compliance program implemented under the temporary regulations is a more efficient and effective manner of deterring serious underwithholding.

Submission of Withholding Exemption Certificates

Under the temporary regulations, employers were no longer routinely required to submit copies of Forms W–4 that met the previously established criteria, often referred to as "Questionable W–4s". Rather, the temporary regulations provided that an employer must submit a copy of any currently effective Form W–4 only if directed to do so in a written notice to the employer from the IRS or if directed to do so under any published guidance.

Some commentators observed that requiring employers to submit questionable Forms W–4 to the IRS may have deterred employees from furnishing a Form W–4 claiming excessive withholding exemptions. Some employers have expressed the concern that eliminating the submission requirement will result in more employees submitting Forms W–4 claiming excessive withholding allowances. While the Department of Treasury and the IRS acknowledge the possible deterrent effect of a requirement to submit certain Forms W–4 to the IRS, they have concluded that the final regulations are a more efficient and effective manner of deterring withholding compliance problems. Accordingly, the final regulations do not require the routine submission of Forms W–4, but permit the IRS to require submission of Forms W–4 under specific criteria either by written notice or by future published guidance. The final regulations do not change an employee's obligations to provide an accurate Form W–4 to an employer and to satisfy his or her tax obligations on a timely basis. Thus, employees may be subject to penalties if they claim excessive withholding exemptions on Forms W–4 or fail to file their tax returns and pay their full tax liabilities on a timely basis.

Some commentators have suggested that if the IRS requires an employer to submit certain Forms W–4 by a written notice or published guidance, the employer should have the ability to provide the requested Forms W–4 by electronic means. The final regulations do not address this comment as the available and appropriate means for submission can be determined by the IRS in specific cases or in the context of any future published guidance requiring the submission of Forms W–4.

Valid and Invalid Withholding Exemption Certificates

In the Preamble to the proposed and temporary regulations, the Department of Treasury and IRS requested comments specifically with regard to the criteria for identifying a valid withholding exemption certificate contained in §31.3402(f)(5)–1(a)(1) of the Employment Tax Regulations. While a few comments were received, they were not likely to provide significant assistance to employers or the IRS in identifying potentially invalid withholding exemption certificates. Accordingly, these final regulations do not change the existing rules on when to treat a withholding exemption certificate as invalid.

Effect of Notice Specifying the Maximum Withholding Exemptions Permitted

The final regulations, like the temporary regulations, authorize the IRS to issue a notice to an employer specifying the maximum number of withholding exemptions permitted for a specific employee. The IRS may issue such a notice after it determines an employee is not entitled to claim exemption from withholding or more than a specified number of withholding exemptions based on IRS records, without first obtaining a copy of the withholding exemption certificate from the employer. Alternatively, the IRS may issue such notice after it reviews a particular withholding exemption certificate and determines that the withholding exemption certificate contains a materially incorrect statement or determines, after a request to the employee for verification of the statements on the certificate, that the IRS lacks sufficient information to determine if the certificate is correct.

The IRS will send the notice both to the employer (with a copy for the employee) and to the employee directly. The final regulations provide a period during which the employee can address the pending withholding adjustment by contacting the IRS. The final regulations provide that the earliest the notice may be effective is 45 calendar days after the date of the notice. The notice may specify a later effective date.

One commentator expressed a concern held by some employers regarding the need to "warehouse" the notice for the 45-day period and suggested that instead the IRS either (1) send the notice first to the employee before involving the employer or (2) not require the employer to implement the notice until a subsequent "final" notice is sent to the employer. The final regulations retain the approach of the proposed and temporary regulations, including a delay period, to balance the need to ensure that the employee receives the notice and to provide time for the employee to discuss the appropriate withholding with the IRS. Consistent with the intent to ensure that the employee receives the notice, the final regulations also provide that if the IRS is unable to determine a last known address for the employee, the IRS will use other available information as appropriate to provide the notice to the employee.

The final regulations also clarify that the notice to an employer specifying the maximum withholding exemptions permitted for a specific employee will also specify the marital status for purposes of calculating the required withholding under the notice. Accordingly, the employer must use the maximum number of withholding exemptions permitted and marital status specified in the notice for calculating income tax withholding, unless a new withholding exemption certificate is submitted by the employee that must be honored under these final regulations. Specifically, if, at any time, the employee furnishes a withholding exemption certificate that claims a marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result from applying the marital status and number of withholding exemptions permitted in the notice, the employer must withhold tax based on that certificate. The IRS may also issue a modification notice to the employer that the employer must implement as of the date in the notice. This notice may change the marital status and/or the maximum number of withholding exemptions permitted.

Although this issue was not raised in the comments, in the course of conducting the withholding compliance program, the IRS has received questions from taxpayers asking about the implications of receiving a notice specifying the maximum number of withholding exemptions permitted and marital status when possible exclusions from withholding apply. Receipt of an IRS notice does not impose a requirement to withhold income taxes where one does not already exist. For example, under section 3401(a)(8)(A)(i) of the Code, employers do not have to withhold income taxes from payments made to employees who are United States citizens working in foreign countries if the employer reasonably believes that the payments are excluded from taxation under section 911 of the Code. Issuance of an IRS notice to an employer properly relying on this exclusion does not impose a withholding requirement on amounts covered by the exclusion. However, if withholding is required, such as on wages paid in excess of the amount excludable under section 911, or if the exclusion ceases to apply to amounts paid by the employer to the employee, the employer must withhold on the basis of the marital status and maximum number of withholding exemptions set forth in the IRS notice. An example has been added to the regulations to illustrate this point.

Employer Furnishing IRS Notice to Employee

The final regulations provide that, if the employee is still employed by the employer, the employer must furnish the notice of maximum number of withholding exemptions permitted to the employee within 10 business days of receipt. Commentators questioned whether they may furnish the employee's copy electronically. The final regulations clarify that the employer may furnish the copy of the IRS notice to the employee within the 10 required business days using any reasonable business practice. For example, an employer might provide the employee with a paper copy of the notice or might transmit a copy using a secure and reliable electronic means of communication.

Terminated, Rehired, and Seasonal Employees

The proposed and temporary regulations provided that the employer is not required to furnish the IRS employee notice to the employee if the employee is no longer employed by the employer. In such a case, the employer must send a written response to the IRS office designated in

the notice indicating that the employee is no longer employed by the employer. Some commentators have expressed concerns over application of the regulations to employees who are not currently performing services, but may resume employment in the future, such as seasonal employees or rehired employees. Specifically, the comments requested assistance in determining when an employee is "no longer employed," and asked whether an employer is required to retain an IRS notice for future implementation should an employee be rehired or resume performance of services. One commentator recommended that the employer be required to retain the notice no later than the end of the calendar year in which the employee terminates, or one year after termination.

After consideration of these comments, the final regulations modify the proposed regulations to clarify that the determination of whether the employee is employed is made as of the date of the notice, and is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for other purposes. The final regulations also specifically state that an employee who is not currently performing services is nevertheless employed for purposes of this rule if on the date of the notice (a) the employer pays wages subject to income tax withholding to the employee with respect to prior employment on or after the date specified in the notice, (b) the employer reasonably expects the employee to resume the performance of services for the employer within twelve months of the date of the notice, or (c) the employee is on a *bona fide* leave of absence if the period of such leave does not exceed twelve months or if the individual retains a right to reemployment with the employer by contract or under an applicable statute, such as the Family Medical Leave Act.

If the employer must furnish the notice under these final regulations, the employer must withhold based on the notice as of the date specified in the notice unless one of the regulatory exceptions applies. Specifically, the employer must withhold based on the notice unless (a) the employer receives a modification notice, (b) the employee has provided or provides a new Form W–4 that results in more withholding than would result based on the notice, (c) the employer is required to furnish the notice only because the employer reasonably expects the employee to resume the performance of services within twelve months of the date of the notice but the employee does not resume the performance of services until after such time, or (d) the employment relationship is terminated for more than twelve months. The regulations include examples to illustrate these requirements.

Notices to Other Employers

One commentator questioned whether an employer has any obligation with respect to an IRS notice issued to another employer, such as a related entity or an employer using the same entity as its "payroll agent," with respect to the same employee. The commentator also proposed that an employer be able to rely on any subsequent notices provided by the IRS with regard to an employee (for example, modifying the maximum number of withholding exemptions permitted) while the employee was employed by another employer.

The final regulations do not adopt these proposals. Other than when an employer qualifies as a "successor employer" within the meaning of section 3121(a)(1) of the Code and §31.3121(a)(1)–1(b) of the Employment Tax Regulations and uses the alternate procedure described in Rev. Proc. 2004–53, 2004–2 C.B. 320, an employer's liability for withholding under section 3402 is determined separately with regard to that employer. Rev. Proc. 2004–53 provides that, under the alternative procedure, the predecessor employer must transfer to the successor employer all current Forms W–4 that were provided to the predecessor by the acquired employees and any written notices received from the IRS under §31.3402(f)(2)–1(g). The revenue procedure also provides that the successor employer must withhold amounts from the employees on the basis of the maximum number of withholding exemptions specified in any written notices from the IRS under §31.3402(f)(2)–1(g). Accordingly, the provision of an IRS notice or a subsequent IRS notice to another employer is not relevant in determining the employer's obligation to withhold income taxes under these final regulations.

Substitute Forms W–4

Some commentators have suggested that employers must refuse to accept substitute Forms W–4 developed by employees. After consideration of this comment, the final regulations provide that employers may not accept a substitute form developed by an employee, and the employee submitting such form will be treated as failing to furnish a withholding exemption certificate.

Effective Date

The final regulations are generally effective on April 14, 2005, the date the temporary regulations were published in the Federal Register. However, the new provisions in the final regulations that (a) specify when an employee who is not currently performing services is employed for purposes of the requirements to furnish the employee notice and withhold based on the notice, (b) require the employer to withhold based on the notice if a terminated employment relationship is resumed within 12 months, and (c) require employers to refuse to accept substitute withholding exemption certificates developed by employees apply on October 11, 2007. However, taxpayers may rely on such provisions for notices issued prior to such date.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Department of Treasury participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE.

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 31.3402(f)(2)–1 is amended by revising paragraph (g) to read as follows:

§31.3402(f)(2)–1 Withholding exemption certificates.

* * * * *

(g) *Submission of certain withholding exemption certificates and notice of the maximum number of withholding exemptions permitted* — (1) *Submission of certain withholding exemption certificates.* — (i) *In general.* An employer must submit to the Internal Revenue Service (IRS) a copy of any currently effective withholding exemption certificate as directed in a written notice to the employer from the IRS or as directed in published guidance.

(A) *Notice to submit withholding exemption certificates.* A notice to the employer to submit withholding exemption certificates may relate either to one or more named employees, to one or more reasonably segregable units of the employer, or to withholding exemption certificates under certain specified criteria. The notice will designate the IRS office where the copies of the withholding exemption certificates must be submitted. Alternatively, upon notice from the IRS, the employer must make available for inspection by an IRS employee withholding exemption certificates received from one or more named employees, from one or more reasonably segregable units of the employer, or from employees who have furnished withholding exemption certificates under certain specified criteria.

(B) *Published guidance.* Employers may also be required to submit copies of withholding exemption certificates under certain specified criteria when directed to do so by the IRS in published guidance. For purposes of the preceding sentence, the term published guidance means a revenue procedure or notice published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(ii) *Withholding after submission of withholding exemption certificate.* After a copy of a withholding exemption certificate has been submitted to the IRS under this paragraph (g)(1), the employer must withhold tax on the basis of the withholding exemption certificate, if the withholding exemption certificate meets the requirements of §31.3402(f)(5)–1. However, the employer may not withhold on the basis of the withholding exemption certificate if the certificate must be disregarded based on a notice of the maximum number of withholding exemptions permitted under the provisions of paragraph (g)(2) of this section.

(2) *Notice of the maximum number of withholding exemptions permitted* — (i) *Notice to employer.* The IRS may notify the employer in writing that the employee is not entitled to claim a complete exemption from withholding or more than the maximum number of withholding exemptions specified by the IRS in the written notice. The notice will also specify the applicable marital status for purposes of calculating the required amount of withholding. The notice will specify the IRS office to be contacted for further information. The notice of maximum number of withholding exemptions permitted may be issued if—

(A) The IRS determines that a copy of a withholding exemption certificate submitted under paragraph (g)(1) of this section or otherwise provided to the IRS contains a materially incorrect statement or determines, after a request to the employee for verification of the statements on the certificate, that the IRS lacks sufficient information to determine if the certificate is correct.

(B) The IRS otherwise determines that the employee is not entitled to claim a complete exemption from withholding and is not entitled to claim more than a specified number of withholding exemptions.

(ii) *Notice to employee.* If the IRS provides a notice to the employer under this paragraph (g)(2), the IRS will also provide the employer with a similar notice for the employee (employee notice) that identifies the maximum number of withholding exemptions permitted and specifies the marital status to be used for calculating the required amount of withholding. The employee notice will also indicate the process by which the employee can provide additional information to the IRS for purposes of determining the appropriate number of withholding exemptions and/or modifying the specified marital status. The IRS will also mail a similar notice to the employee's last known address. For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. If the IRS is unable to determine a last known address for the employee, the IRS will use other available information as appropriate to mail the notice to the employee.

(iii) *Requirement to furnish.* If the employee is employed by the employer as of the date of the notice, the employer must furnish the employee notice to the employee within 10 business days of receipt. The employer may follow any reasonable business practice to furnish the copy of the notice to the employee. For purposes of this paragraph (g)(2)(iii), the determination of whether an employee is employed as of the date of the notice is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for other purposes. An employee that is not performing services for the employer as of the date of the notice is employed by the employer as of the date of the notice for purposes of this paragraph (g)(2)(iii) if—

(A) The employer pays wages with respect to prior employment to the employee subject to income tax withholding on or after the date specified in the notice;

(B) The employer reasonably expects the employee to resume the performance of services for the employer within twelve months of the date of the notice; or

(C) The employee is on a *bona fide* leave of absence if the period of such leave does not exceed twelve months or the employee retains a right to reemployment with the employer under an applicable statute or by contract.

(iv) *Requirement to notify the IRS.* If the employer is not required to furnish the notice to the employee under paragraph (g)(2)(iii) of this section, the employer must send a written response to the IRS office designated in the notice indicating that the employee is not employed by the employer.

(v) *Requirement to withhold based on the notice.* If the employer is required to furnish the employee notice to the employee under paragraph (g)(2)(iii) of this section, then the employer must withhold tax on the basis of the maximum number of withholding exemptions and the marital status specified in the notice for any wages paid after the date specified in the notice, except as provided in paragraphs (g)(2)(vi), (vii), (viii), (ix), and (x) of this section. The employer must withhold tax in accordance with the notice as of the date specified in the notice, which shall be no earlier than 45 calendar days after the date of the notice.

(vi) *Employment resumes after twelve months.* If the employer is required to furnish the employee notice to the employee only pursuant to paragraph (g)(2)(iii)(B) of this section and the employee resumes the performance of services for the employer more than 12 months after the date of the notice, then the employer is not required to withhold based on the notice.

(vii) *Requirement to withhold based on an existing Form W–4.* If a withholding exemption certificate is in effect with respect to the employee before the employer receives a notice of the maximum number of withholding exemptions permitted under this paragraph (g)(2) of this section, the employer must continue to withhold tax in accordance with the existing withholding exemption certificate, rather than on the basis of the notice, if the existing withholding exemption certificate does not claim complete exemption from withholding and claims a marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result from applying the marital status and number of withholding exemptions specified in the notice.

(viii) *Modification notice.* After issuing the notice specifying the maximum number of withholding exemptions permitted and the marital status, the IRS may issue a subsequent notice that modifies the original notice (modification notice). The modification notice may change the marital status and/or the number of withholding exemptions permitted. The employer must withhold based on the modification notice as of the date specified in the modification notice.

(ix) *Requirement to withhold after termination of employment.* If the employee is employed as of the date of the notice under paragraph (g)(2)(iii) of this section, but the employer or employee terminates the employment relationship after the date of the notice, the employer must continue to withhold based on the maximum number of withholding exemptions and the marital status specified in the notice or a modification notice if any wages subject to income tax withholding are paid with respect to the prior employment after such date. Furthermore, the employer must withhold based on the notice or modification notice if the employee resumes an employment relationship with the employer within 12 months after the termination of the employment relationship. Whether the employment relationship is terminated is based on all the facts and circumstances.

(x) *Requirement to withhold based on new Form W–4.* The employee may furnish a new withholding exemption certificate after the employer receives a notice or modification notice from the IRS of the maximum number of withholding exemptions permitted under this paragraph (g)(2).

(A) *Employee requests more withholding.* If the employee furnishes a new withholding exemption certificate after the employer receives the notice or modification notice, the employer must withhold tax on the basis of that new certificate only if the new certificate does not claim complete exemption from withholding and claims a marital status, a number of withholding exemptions, and any additional withholding that results in more withholding than would result under the notice or modification notice.

(B) *Employee requests less withholding.* If the employee furnishes a new withholding exemption certificate after the employer receives the notice or modification notice, the employer must disregard the new certificate and withhold on the basis of the notice or modification notice if the employee claims complete exemption from withholding or claims a marital status, a number of withholding exemptions, and any additional withholding that results in less withholding than would result under the notice or modification notice. If the employee wants to put a new certificate into effect that results in less withholding than that required under the notice or modification notice, the employee must contact the IRS. The employer must withhold on the basis of the notice or modification notice unless the IRS subsequently notifies the employer to withhold based on the new certificate.

(3) *Definition of employer.* For purposes of this paragraph (g), the term employer includes any person authorized by the employer to receive withholding exemption certificates, to make withholding computations, or to make payroll distributions.

(4) *Examples.* The following examples illustrate the rules of this section.

Example 1. Employer U receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee A. Employee A is not currently performing any services for Employer U. However, Employer U is continuing to make certain wage payments to Employee A. Employer U must furnish the employee notice to Employee A within 10 business days of receipt and must withhold based on the notice on any wages paid to Employee A on or after the date specified in the notice.

Example 2. Employer V receives a notice in October of Year 1 from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee B. Employee B has not performed services for Employer V since August of Year 1. However, since Employee B has performed services for Employer V for several years on a seasonal basis, Employer V reasonably expects Employee B to resume the performance of services for Employer V in June of Year 2, a date that is within 12 months of the date of the notice. Employer V is required to furnish the notice to Employee B within 10 business of receipt. Employee B does not resume the performance of services until June of Year 3. Employer V is not required to withhold based on the notice.

Example 3. Employer W receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee C. Employee C began a 4-month unpaid maternity leave of absence three weeks before Employer W received the notice. Employer W must furnish the employee notice to Employee C within 10 business days of receipt. When Employee C resumes performing services when her maternity leave ends, Employer W must withhold based on the notice.

Example 4. Employer X receives a notice from the IRS in Year 1 that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee D. Employer X must furnish the employee notice to Employee D within 10 business days of receipt and withhold based

on the notice. In Year 2, Employee D terminates the employment relationship. Employee D applies for a different position with Employer X and resumes employment 10 months after having left her previous position with Employer X. Since Employer X rehired Employee D within 12 months after the termination of employment, Employer X must withhold based on the notice.

Example 5. Employer Y receives a notice from the IRS that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee E. Employer Y must furnish the employee notice to Employee E within 10 business days of receipt. After receipt of this notice, Employee E contacts the IRS and establishes that he is entitled to claim a higher number of withholding exemptions. Employer Y receives a modification notice from the IRS that changes the maximum number of withholding exemptions permitted for Employee E. Employer Y must withhold tax based on the modification notice as of the date specified in such notice.

Example 6. Employer Z pays remuneration to Employee F, a United States citizen, for services performed in Country M. Employer Z receives a notice from the IRS in Year 1 that identifies the maximum number of withholding exemptions permitted and specifies the marital status for Employee F. Employer Z must furnish the employee notice to Employee F within 10 business days of receipt. Employer Z reasonably believes all the remuneration paid to Employee F in Year 1 is excluded from Employee F's gross income under section 911 of the Internal Revenue Code. Since section 3401(a)(8)(B) excludes such remuneration from wages for income tax withholding purposes, Employer X does not have to withhold on such remuneration, notwithstanding the maximum number of exemptions permitted and marital status specified in the notice. In Year 2, Employee F returns to the United States to perform services. Employer Z does not reasonably believe any part of Employee F's remuneration paid in Year 2 is excluded from Employee F's gross income under section 911. Rather, Employer Z reasonably believes that remuneration paid to Employee F in Year 2 is subject to income tax withholding. Employer Z must withhold on the remuneration paid to Employee F based on the notice.

(5) *Effective/applicability date.* Except as provided in this paragraph (g)(5), paragraph (g) applies on April 14, 2005. Paragraphs (g)(2)(iii)(A), (B), and (C) and paragraph (g)(2)(ix) apply on October 11, 2007, except taxpayers may rely on such paragraphs for notices issued prior to such date.

§31.3402(f)(2)–1T [Removed]

Par. 3. Section 31.3402(f)(2)–1T is removed.

Par. 4. Section 31.3402(f)(5)–1 is amended by revising paragraph (a) to read as follows:

§31.3402(f)(5)–1 Form and contents of withholding exemption certificates.

(a)(1) *Form W–4.* Form W–4, "*Employee's Withholding Allowance Certificate*," is the form prescribed for the withholding exemption certificate required to be furnished under section 3402(f)(2). A withholding exemption certificate must be prepared in accordance with the instructions and regulations applicable thereto, and must set forth fully and clearly the data that is called for therein. Blank copies of paper Forms W–4 will be supplied to employers upon request to the Internal Revenue Service (IRS). An employer may also download and print Form W–4 from the IRS Internet site at *www.irs.gov*. In lieu of the prescribed form, employers may prepare and use a form the provisions of which are identical with those of the prescribed form, but only if employers also provide employees with all the tables, instructions, and worksheets contained in the Form W–4 in effect at that time, and only if employers comply with all revenue procedures relating to substitute forms in effect at that time.

(2) Employers are prohibited from accepting a substitute form developed by an employee, and the employee submitting such form will be treated as failing to furnish a withholding exemption certificate. For further guidance regarding the employer's obligations when an employee is treated as failing to furnish a withholding exemption certificate, see §31.3402(f)(2)–1.

(3) *Effective/applicability date.* Paragraph (a)(1) applies on April 14, 2005. Paragraph (a)(2) applies to any substitute withholding exemption certificate furnished to an employer on or after October 11, 2007.

* * * * *

§31.3402(f)(5)–1T [Removed]

Par. 5. Section 31.3402(f)(5)–1T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2007, 72 F.R. 38478)

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012–2: Corporations required to make returns of income.

T.D. 9336

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Return Required by Subchapter T Cooperatives Under Section 6012

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that prescribe the form that cooperatives must use to file their income tax returns. The regulations affect all cooperatives that are currently required to file an income tax return on either Form 1120, "*U.S. Corporation Income Tax Return*," or Form 990–C, "*Farmers' Cooperative Association Income Tax Return*." The new form will help the IRS to properly identify cooperatives and differentiate between cooperatives that must file returns within 2½ months of the end of the taxable year and those that must file within 8½ months of the end of the taxable year.

DATES: *Effective date:* These regulations will be effective July 30, 2007.

Applicability date: These regulations apply to returns for taxable years ending on or after December 31, 2007. In addition, taxpayers may rely on the regulations in filing returns for taxable years ending on or after December 31, 2006, and before December 31, 2007.

FOR FURTHER INFORMATION CONTACT: Matthew P. Howard, (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Under existing regulations, all cooperatives to which subchapter T applies (Subchapter T cooperatives) are required to make income tax returns. Except in the case of farmers' cooperatives, the regulations require that the return be made on Form 1120. In the case of farmers' cooperatives, the regulations require that the return be made on Form 990–C.

Most taxpayers required to make an income tax return on Form 1120 must file their return on or before the 15th day of the third month following the close of the taxpayer's taxable year (2½ month deadline). Some Subchapter T cooperatives that make their returns on Form 1120 are required to file by the 2½ month deadline, but others are not required to file their returns until the 15th day of the ninth month following the close of the taxpayer's taxable year (8½ month deadline). Because the Form 1120 does not distinguish between Subchapter T cooperatives that must file by the 2½ month deadline and those that must file by the 8½ month deadline, the IRS has difficulty determining which filing deadline applies and deciding whether to assert delinquency and failure to pay penalties in the case of returns filed after the 2½ month deadline.

The Proposed Regulations

On July 29, 2005, a notice of proposed rulemaking was published in the **Federal Register** (REG–149436–04, 2005–2 C.B. 454 [70 FR 43811]). The proposed regulations in this notice of proposed rulemaking would require all Subchapter T cooperatives to make their income tax returns on Form 1120–C, "*U.S. Income Tax Return for Cooperative Associations*," or such other form as may be designated by the Commissioner.

One telephone comment was received in response to the notice of proposed rulemaking. The comment suggested that the new form might have a negative effect on consolidated filing. No public hearing was requested or held.

Explanation of Provisions

After consideration of the comment, the proposed regulations are adopted as revised by this Treasury decision. The final regulations retain the requirement that Subchapter T cooperatives file their returns on Form 1120–C. The information that Subchapter T cooperatives will be required to provide on new Form 1120–C will assist taxpayers and the IRS in determining the appropriate filing deadline. Having that information will reduce the burden on taxpayers and will help the IRS avoid asserting penalties in inappropriate cases. Having all Subchapter T cooperatives make their income tax returns on Form 1120–C will also eliminate confusion over which form to file and will promote efficiency in addressing income tax issues common to Subchapter T cooperatives.

The IRS and Treasury Department believe that this requirement will not have a negative effect on consolidated filing. Subchapter T cooperatives may continue to file returns on behalf of consolidated groups by indicating their filing status on Form 1120–C and complying with the regulations under section 1502 of the Internal Revenue Code (Code).

This requirement to use Form 1120–C was proposed to be effective for taxable years ending on or after December 31, 2006. Because the regulations were not finalized before the end of 2006, the final regulations delay the proposed effective date. The final regulations apply beginning with the first taxable year ending on or after December 31, 2007. Cooperatives may rely on the regulations as proposed, however, and file returns on Form 1120–C for taxable years ending on or after December 31, 2006, and before December 31, 2007.

Effect on Other Documents

The following publications are obsoleted as of July 30, 2007.

Announcement 84–26, 1984–11 I.R.B. 42.

Announcement 84–37, 1984–17 I.R.B. 32.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Matthew P. Howard, Office of Associate Chief Counsel (Procedure & Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6012–2 is amended by revising paragraph (f) to read as follows:

§1.6012–2 Corporations required to make returns of income.

* * * * *

(f) *Subchapter T cooperatives*—(1) *In general*. For taxable years ending on or after December 31, 2007, a cooperative organization described in section 1381 (including a farmers' cooperative exempt from tax under section 521) is required to make a return, whether or not it has taxable income and regardless of the amount of its gross income, on Form 1120–C, "*U.S. Income Tax Return for Cooperative Associations*," or such other form as may be designated by the Commissioner.

(2) *Farmers' cooperatives*. For taxable years ending before December 31, 2007, a farmers' cooperative organization described in section 521(b)(1) (including

a farmers' cooperative that is not exempt from tax under section 521) is required to make a return on Form 990–C, "*Farmers' Cooperative Association Income Tax Return.*"

(3) *Effective/applicability date.* This paragraph (f) is applicable on or after July 30, 2007.

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved June 27, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 27, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 30, 2007, 72 F.R. 41441)

Section 6038.—Information Reporting With Respect to Certain Foreign Corporations and Partnerships

26 CFR 1.6038–2: Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

T.D. 9338

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Information Returns Required With Respect to Certain Foreign Corporations and Certain Foreign-Owned Domestic Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance under sections 6038 and 6038A of the Internal Revenue Code (Code). The final regulations clarify the information required to be furnished regarding certain related party transactions of certain foreign corporations and certain foreign-owned domestic corporations. The final regulations also increase the amount of certain penalties, and make certain other changes, to reflect the statutory changes made by the Taxpayer Relief Act of 1997.

DATES: *Effective Date:* These regulations are effective July 13, 2007.

Applicability Date: For dates of applicability, see §§1.6038–2(m) and 1.6038A–2(h).

FOR FURTHER INFORMATION CONTACT: Kate Y. Hwa (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2020. Responses to this collection of information are mandatory.

The collection of information is in §1.6038–2(f)(11). This information is required by the IRS pursuant to section 6038 of the Code. The likely recordkeepers are business or other for-profit institutions. The estimated burden is as follows:

Estimated total annual reporting and/or recordkeeping burden: 1250 hours.

Estimated average annual burden per respondent: 15 minutes.

Estimated number of respondents: 5,000.

Estimated annual frequency of responses: once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains final amendments to the Income Tax Regulations (26 CFR part 1) under sections 6038 and 6038A of the Code. On June 21, 2006, final and temporary regulations (T.D. 9268, 2006–30 I.R.B. 94) under sections 6038 and 6038A were published in the **Federal Register** (71 FR 35524). On the same day, a notice of proposed rulemaking (REG–109512–05, 2006–30 I.R.B. 100) was published by cross-reference to the temporary regulations in the **Federal Register** (71 FR 35592). The preamble of T.D. 9268 includes background information and an explanation of provisions regarding these regulations.

The IRS received no comments in response to the notice of proposed rulemaking. No requests to speak at a public hearing were received and no hearing was held. Accordingly, the proposed regulations are adopted without change by this Treasury decision and the corresponding temporary regulations are removed or removed and reserved.

The Treasury Department, however, is considering additional information reporting pursuant to section 6038A of the Code regarding section 163(j) to further the administration of the earning stripping rules.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations only affect entities with significant foreign operations and any burden on small entities is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration

for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Kate Y. Hwa, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6038–2 is amended as follows:

1. Paragraphs (a)(1) and (a)(2) are revised.

2. Paragraphs (f)(11), (f)(12), (k)(1) and (m) are revised.

3. Paragraph (k)(5) is amended by adding *Examples 3* and *4*.

The revisions and additions read as follows:

§1.6038–2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

(a) * * *

(1) Form 2952, "*Information Return with Respect to Controlled Foreign Corporations*," if such taxable year ends before December 31, 1982;

(2) Form 5471, "*Information Return of U.S. Persons With Respect To Certain Foreign Corporations*," if such taxable year ends on or after December 31, 1983; or

* * * * *

(f) * * *

(11) *Transactions with certain related parties.* (i) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the person required to file this return, any other corporation or partnership controlled by that person, or any United States person owning at the time of the transaction 10 percent or more in value of any class of stock outstanding of the foreign corporation, or of any corporation controlling that foreign corporation—

(A) Sales and purchases of stock in trade;

(B) Sales and purchases of tangible property other than stock in trade;

(C) Sales and purchases of patents, inventions, models, or designs (whether or not patented), copyrights, trademarks, secret formulas or processes, or any other similar property rights;

(D) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(E) Commissions paid and commissions received;

(F) Rents and royalties paid and rents and royalties received;

(G) Amounts loaned and amounts borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (f)(11) that arise and are collected in full in the ordinary course of business);

(H) Dividends paid and dividends received;

(I) Interest paid and interest received; and

(J) Premiums paid and premiums received for insurance or reinsurance.

(ii) *Special rule for banks.* For purposes of this paragraph (f)(11), if the United States person is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term transactions shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, deposits in accounts between a foreign corporation, controlled (within the meaning of paragraph (b) of this section) by a United States person, and a person described in this paragraph (f)(11) and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(12) *Accrued payments and receipts.* For purposes of the required summary under paragraph (f)(11) of this section, a corporation that uses an accrual method of accounting shall use accrued payments and accrued receipts for purposes of computing the total amount of each of the types of transactions listed.

* * * * *

(k) *Failure to furnish information*—(1) *Dollar amount penalty*—(i) *In general.* If any person required to file Form 5471 under section 6038 and this section fails to furnish any information described in paragraphs (f) and (g) of this section within the time prescribed by paragraph (i) of this section, such person shall pay a penalty of $10,000 for each annual accounting period of each foreign corporation with respect to which such failure occurs.

(ii) *Increase in penalty for continued failure after notification.* If a failure described in paragraph (k)(1)(i) of this section continues for more than 90 days after the date on which the Director of Field Operations, Area Director, or Director of Compliance Campus Operations mails notice of such failure to the person required to file Form 5471, such person shall pay a penalty of $10,000, in addition to the penalty imposed by section 6038(b)(1) and paragraph (k)(1)(i) of this section, for each 30-day period (or a fraction of) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038(b)(2) and this paragraph (k)(1)(ii) shall be limited to a maximum of $50,000 for each failure.

* * * * *

(5) * * *

Example 3. A, a US person, owns 100 percent of the stock of FC. On April 15, 2008, A timely filed its 2007 income tax return but did not file Form 5471 with respect to FC's 2007 annual accounting period. On June 1, 2008, the Director of Field Operations mailed a notice to A of A's failure to file Form 5471 for 2007 with respect to FC. On August 1, 2008, A submits a written statement asserting facts for reasonable cause for failure to file the 2007 Form 5471 for FC. Based on A's statement and discussions with A, the Director of Field Operations agrees that A had reasonable cause for failure to file FC's 2007 Form 5471 and determined that it is reasonable for A to file FC's 2007 Form 5471 by September 15, 2008. The time prescribed for furnishing information under paragraph (i) of this section is September 15, 2008, and the 90-day period described under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section begins on that same date. Thus, if A files a completed Form 5471 by September 15, 2008, A is not subject to the penalties under paragraphs (k)(1) and (k)(2) of this section. If A does not file a completed Form 5471 by December 14, 2008, in addition to the penalties under paragraphs (k)(1) and (k)(2) of this section, A will also be subject to the penalties for continued failure under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section.

Example 4. The facts are the same as in *Example 3* except A submits the written statement to the Director before a notice of failure to furnish information is mailed to A. The notice is mailed to A on September 7, 2008. Under these facts, the time prescribed for furnishing information under paragraph (i) of this section is September 15, 2008, and the 90-day period after mailing of notice of failure under paragraphs (k)(1)(ii) and (k)(2)(iv)(A) of this section begins on that same date.

* * * * *

(m) *Effective/applicability dates.* Except as otherwise provided, this section applies with respect to information for annual accounting periods beginning on or after June 21, 2006. Paragraphs (k)(1) and (k)(5) *Examples 3* and *4* of this section apply June 21, 2006.

§§1.6038–2T [Amended]

Par. 3. In §1.6038–2T, paragraphs (e) through (m) are revised to read as follows:

§1.6038–2T Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations (temporary).

* * * * *

(e) through (l) [Reserved]. For further guidance, see §1.6038–2(e) through (l).

(m) *Effective/applicability date.* Paragraph (d) of this section shall apply for taxable years ending after October 22, 2004.

Par. 4. Section 1.6038A–2 is amended by revising paragraphs (b)(8) and (h) to read as follows:

§1.6038A–2 Requirement of return.

* * * * *

(b) * * *

(8) *Accrued payments and receipts.* For purposes of this section, a reporting corporation that uses an accrual method of accounting shall use accrued payments and accrued receipts for purposes of computing the total amount of each of the types of transactions listed in this section.

* * * * *

(h) *Effective/applicability date.* Except as otherwise provided, for effective dates for this section for certain reporting corporations, see §1.6038A–1(n). Paragraph (b)(8) of this section applies with respect to information for annual accounting periods beginning on or after June 21, 2006.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 13, 2007, 72 F.R. 38475)

Transition Relief Regarding the Active Trade or Business Requirement for Certain Transactions

Notice 2007–60

This notice provides transition relief to taxpayers applying § 1.355–3(b)(4)(iii) of the Income Tax Regulations and § 355(b)(2)(C) and (D) of the Internal Revenue Code to certain transactions described in this notice.

SECTION 1. BACKGROUND

Section 355 sets forth the requirements of a tax-free distribution by a corporation of stock of a controlled subsidiary. Section 355(b) conditions the tax-free status of the distribution on the trade or business activities of the relevant corporations and the manner in which those activities were acquired. Generally, § 355(b)(2)(A) provides that a corporation shall be treated as engaged in the active conduct of a trade or business if and only if it is engaged in the active conduct of a trade or business. Section 355(b)(2)(B) requires that the trade or business have been actively conducted throughout the five-year period ending on the date of the distribution (pre-distribution period). Section 355(b)(2)(C) provides that the trade or business must not have been acquired in a transaction in which gain or loss was recognized, in whole or in part, within the pre-distribution period. Section 355(b)(2)(D) provides that control (as defined in § 368(c)) of a corporation which (at the time of acquisition of control) was conducting the trade or business must not have been directly or indirectly acquired by any distributee corporation or by the distributing corporation during the pre-distribution period in a transaction in which gain or loss was recognized, in whole or in part.

SECTION 2. APPLICABILITY OF § 1.355–3(b)(4)(iii)

Section 1.355–3(b)(4)(iii) provides an exception to the general no gain or loss rule in § 355(b)(2)(C) and (D), stating that "[a] direct or indirect acquisition of a trade or business by one member of an affiliated group from another member of the group is not the type of transaction to which section 355(b)(2)(C) and (D) is intended to apply. Therefore, in applying section 355(b)(2)(C) or (D), such an acquisition, even though taxable, shall be disregarded." While § 1.355–3(b)(4) is generally applicable to distributions on or before December 15, 1987, the IRS has applied it administratively to distributions occurring after that date, consistent with the amendments to § 355(b)(2)(D) in 1987 and 1988. See Public Law 100–203 (101 Stat. 1330, 1330–411 (1987)) and Public Law 100–647 (102 Stat. 3342, 3605 (1988)).

Section 355(b) was amended again on May 17, 2006. See Section 202 of the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345, 348) and Section 410 of division A of the Tax Relief and Health Care Act of 2006, Public Law 109–432 (120 Stat. 2922, 2963). This amendment added § 355(b)(3), which provides that a corporation shall be treated as meeting the requirement of § 355(b)(2)(A) if and only if such corporation is engaged in the active conduct of a trade or business. Section 355(b)(3)(B) provides that for purposes of § 355(b)(3)(A) (and, consequently, § 355(b)(2)(A)), all members of such corporation's separate affiliated group (SAG) shall be treated as one corporation.

The IRS and Treasury Department have interpreted § 355(b)(3) as calling into question whether the regulation quoted above appropriately reflects the statute as amended in 2006. See Notice of Proposed Rulemaking, Guidance Regarding the Active Trade or Business Requirement Under Section 355(b), 72 Fed. Reg. 26012 (No. 88) (May 8, 2007) (proposing to modify § 1.355–3) (NPRM). However, consistent with past administrative practice, the IRS will not challenge the applicability of the rule stated in § 1.355–3(b)(4)(iii) to distributions effected on or before the date of publication in the Federal Register of temporary or final regulations modifying the rule stated in § 1.355–3(b)(4)(iii).

SECTION 3. CERTAIN ACQUISITIONS OF ADDITIONAL STOCK OF THE CONTROLLED CORPORATION

Section 355(b)(2)(C) by its terms applies to asset acquisitions while § 355(b)(2)(D) applies to stock acquisitions. The IRS and Treasury Department have interpreted § 355(b)(3) as modifying the applicability of § 355(b)(2)(C) and (D). Section 355(b)(3) essentially treats a stock acquisition that results in the acquired corporation becoming a subsidiary member of the acquiring corporation's SAG as an asset acquisition for purposes of § 355(b). See NPRM. Accordingly, the IRS and Treasury Department have concluded that such a stock acquisition is subject to § 355(b)(2)(C) regardless of whether it results in an acquisition of control that would otherwise be subject to § 355(b)(2)(D). See NPRM.

Acquisitions of stock of the controlled corporation that result in the controlled corporation becoming a member of the distributing corporation's SAG are treated as asset acquisitions that are subject to § 355(b)(2)(C) regardless of whether the distributing corporation already controlled the controlled corporation. Specifically, such an acquisition could violate § 355(b)(2)(C) notwithstanding the fact that it would not violate § 355(b)(2)(D) because there was no acquisition of control.

For example, assume that for more than five years, corporations D and C have each engaged in the active conduct of a trade or business. The trades or businesses are not in the same line of business. Throughout this period, D has owned stock of C constituting control (as defined in § 368(c)) but not meeting the requirements of § 1504(a)(2). In year 6, D purchases for cash the remainder of the C stock from an unrelated party. The purchase of the additional C stock does not violate § 355(b)(2)(D) because D already owned stock of C constituting control. However, because after the purchase D owns stock of C meeting the requirements of § 1504(a)(2), C becomes a member of D's SAG, and D and C are treated as one corporation for purposes of the active trade or business requirement.

Accordingly, for § 355(b) purposes, D has acquired the assets of C in a transaction in which gain or loss was recognized in violation of § 355(b)(2)(C).

Taxpayers may not have anticipated that such acquisitions of additional stock of the controlled corporation would adversely impact the controlled corporation's ability to satisfy the active trade or business requirement. Accordingly, the IRS will not challenge the distributing corporation's (or its SAG's) acquisition of additional stock of the controlled corporation as a violation of § 355(b)(2)(C) with respect to the controlled corporation in the case of distributions effected on or before the date the proposed regulations in the NPRM are published as temporary or final regulations in the Federal Register, provided that the transaction satisfies the requirements of § 355(b)(2)(D) as in effect before the enactment of § 355(b)(3).

SECTION 4. COMMENTS

The IRS welcomes comments on whether similar treatment would be appropriate with respect to any other potential effects of the recent amendments to § 355(b). Comments may be forwarded in the manner provided in the NPRM.

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are Russell P. Subin and Rubin B. Ranat of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice, contact Mr. Subin at (202)–622–7790 or Mr. Ranat at (202) 622–7530 (not toll-free calls).

Extension of Transition Relief for Indian Tribal Government Plans

Notice 2007–67

I. Purpose

The purpose of this notice is to extend the transitional relief provided to plans of Indian tribal governments and certain related entities under Notice 2006–89, 2006–43 I.R.B. 772, to the date that is six months after guidance is issued under § 414(d) of the Code, as amended by section 906 of the Pension Protection Act of 2006, on the determination of whether a retirement plan maintained by an Indian tribal government is a governmental plan with the meaning of § 414(d) of the Code.

II. Background

Section 414(d) of the Code provides that a "governmental plan" includes a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. Certain plans of Indian tribal governments (ITGs) are also governmental plans under § 414(d). Specifically, section 906(a)(1) of the Pension Protection Act of 2006 (PPA '06) amended § 414(d) of the Code with respect to ITG plans to provide that:

> The term 'governmental plan' includes a plan which is established and maintained by an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), or an agency or instrumentality of either, and all of the participants of which are employees of such entity substantially all of whose services as such an employee are in the performance of essential governmental functions but not in the performance of commercial activities (whether or not an essential government function).

The provisions of section 906 of PPA '06 apply to plan years beginning on or after August 17, 2006 (PPA's date of enactment). For example, an ITG plan with an October 1 to September 30 plan year is a governmental plan under § 414(d) as amended by PPA '06 only if it satisfies this definition in operation beginning on October 1, 2006.

Notice 2006–89 provides that the Service and Treasury anticipate issuing guidance on § 414(d) as amended and that, until such guidance is issued, an ITG plan will be treated as satisfying the requirements to be a governmental plan under § 414(d) if it complies with those requirements based on a reasonable and good faith interpretation of the amendment made by section 906(a)(1) of PPA '06. Section III.B. of the notice provides certain approaches that, if taken by September 30, 2007, permit separate plans to be established for commercial ITG employees and for other ITG employees who perform essential governmental functions (governmental ITG employees) under the reasonable and good faith compliance standard. Section III.E. indicated that the relief provided in Section III applied pending the issuance of further guidance relating to § 414(d), including the amendment made by section 906(a)(1) of PPA '06. The notice also invited comments from the public on whether additional transition issues need to be addressed.

III. Extension of Transition Relief under Notice 2006–89

Since the issuance of Notice 2006–89, the Service and Treasury have continued to consult with Indian tribal government representatives. Based on those consultations and the comments received in response to Notice 2006–89, and until future guidance is issued, the transition relief provided under Notice 2006–89 is hereby revised so that the date "September 30, 2007" in Section III.B. of Notice 2006–89 is replaced with "the date that is six months after guidance is issued under § 414(d) of the Code, as amended by section 906 of the Pension Protection Act of 2006, on the determination of whether a retirement plan maintained by an ITG is a governmental plan with the meaning of § 414(d)."

This extension is conditioned on the plans involved not being amended, for periods before the extended date, to reduce benefits unless the reduction: (i) does not vary based upon whether the participant is a governmental ITG employee or a commercial ITG employee, or (ii) is made to the plan for commercial ITG employees and is the minimum reduction necessary to satisfy the requirements of the Code. If a reduction occurs that does not meet either of these conditions, the extension provided under this notice ends on the date the reduction goes into effect.

IV. Effect on Other Documents

Notice 2006–89 is modified.

Drafting Information

The principal author of this notice is Diane S. Bloom of the Employee Plans,

Tax Exempt and Government Entities Division. For further information regarding this notice, please call the Employee Plans customer assistance service Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time at (877) 829–5500 (a toll-free number) or email *RetirementPlanQuestions@irs.gov*.

Weighted Average Interest Rates Update

Notice 2007–68

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II).

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for July 2007 is 6.33 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in: Month	Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
August	2007	5.84	5.26 to 5.84

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for July 2007 is 5.11 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2037.

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 877–829–5500 (a toll-free number), between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 202–283–9703. Mr. Montanaro may be reached at 202–283–9714. The telephone numbers in the preceding sentences are not toll-free.

Relief Related to Plan Amendment of Definition of Normal Retirement Age

Notice 2007–69

I. Purpose

This notice provides temporary relief, until the first day of the first plan year that begins after June 30, 2008, for certain pension plans under which the definition of normal retirement age may be required to be changed to comply with the regulations relating to a plan's normal retirement age that were recently issued under § 401(a) of the Internal Revenue Code. This notice also identifies potential violations of the vesting and accrued benefit requirements for defined benefit plans under § 411 that may arise from a definition of normal retirement age based on a minimum period of service. Finally, this notice requests comments from sponsors of governmental plans as defined in § 414(d)) and other plans not subject to the requirements of § 411 on whether such a plan may de-

fine normal retirement age based on years of service.

II. Background

A. Regulations on Definition of Normal Retirement Age

Section 411(a)(8) provides that the term "normal retirement age" means the earlier of (A) the time a plan participant attains normal retirement age under the plan or (B) the later of age 65 or the fifth anniversary of the time a plan participant commenced participation in the plan. A plan's normal retirement age is relevant for a number of purposes, including for purposes of determining the date at which a participant is eligible to receive his or her normal retirement benefit and calculating the amount of the benefit received.

On May 22, 2007, final regulations on distributions from a pension plan upon attainment of normal retirement age were published in the Federal Register as T.D. 9325, 2007–24 I.R.B. 1386 (72 FR 28604) ("2007 regulations"). The 2007 regulations modified § 1.401(a)–1 of the Income Tax Regulations, which generally requires a pension plan to be maintained primarily to provide systematically for the payment of definitely determinable benefits after retirement, by adding in part new paragraphs (b)(2), (3) and (4).

Section 1.401(a)–1(b)(2) of the 2007 regulations provides an exception to the rule that pension benefits be paid only after retirement by permitting a pension plan, as defined in § 1.401–1(a)(2)(i) and § 1.401–1(b)(1)(i), to commence payment of retirement benefits to a participant after the participant has attained normal retirement age even if the participant has not yet had a severance from employment with the employer maintaining the plan.

Section 1.401(a)–1(b)(2)(i) of the 2007 regulations provides, as a general rule, that the normal retirement age under a plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

Section 1.401(a)–1(b)(2)(ii) of the 2007 regulations provides, as a safe harbor, that a normal retirement age of at least age 62 is deemed to be not earlier than the typical retirement age for the industry in which the covered workforce is employed. Thus, a plan satisfies this safe harbor if its normal retirement age is age 62, or if its normal retirement age is the later of age 62 or another specified date, such as the later of age 62 or the fifth anniversary of plan participation (but not later than the later of age 65 or the fifth anniversary of plan participation, in the case of a plan subject to § 411).

Section 1.401(a)–1(b)(2)(iii) of the 2007 regulations provides that, if a plan's normal retirement age is between the ages of 55 and 62, the determination of whether the age is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed is based on all of the relevant facts and circumstances. The preamble to the regulations provides that it is generally expected that a good faith determination made by the employer (or, in the case of a multiemployer plan, made by the trustees) that the typical retirement age for the industry in which the covered workforce is employed is an age between age 55 and age 62 will be given deference, assuming that the determination is reasonable under the facts and circumstances.

Section 1.401(a)–1(b)(2)(iv) of the 2007 regulations provides that a normal retirement age that is below age 55 is presumed to be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed, unless the Commissioner determines that under the facts and circumstances the normal retirement age is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

Section 1.401(a)–1(b)(2)(v) of the 2007 regulations provides that in the case of a plan where substantially all of the participants are qualified public safety employees (within the meaning of § 72(t)(10)(B)), a normal retirement age of age 50 or later is deemed not to be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered work force is employed.

Section 1.401(a)–1(b)(3) of the 2007 regulations provides that, for purposes of whether a pension plan is maintained primarily to provide systematically for the payment of definitely determinable benefits after retirement, "retirement" does not include a mere reduction in hours worked. Thus, benefits may not be distributed prior to normal retirement age solely due to a reduction in the number of hours that an employee works.

Section 1.401(a)–1(b)(4) of the 2007 regulations provides that paragraphs 1.401(a)–1(b)(2) and (3) are generally effective as of May 22, 2007, the date of their publication in the Federal Register. In the case of a governmental plan (as defined in § 414(d)), paragraphs (b)(2) and (b)(3) are effective for plan years beginning on or after January 1, 2009. In the case of a plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on May 22, 2007, paragraphs (b)(2) and (b)(3) do not apply before the first plan year that begins after the last of the agreements terminates determined without regard to any extension thereof (or, if earlier, May 24, 2010).

A provision of a plan that results in the failure of the plan to satisfy § 1.401(a)–1(b)(2) or (3) is a disqualifying provision described in § 1.401(b)–1(b)(3)(i). Therefore, the remedial amendment period rules of § 1.401(b)–1 apply. For example, in the case of a plan with a calendar plan year that is maintained by an employer with a calendar taxable year (and the plan is not a governmental plan and is not maintained pursuant to a collective bargaining agreement), the plan's remedial amendment period with respect to § 1.401(a)–1(b)(2) and (3) ends on the date prescribed by law for the filing of the employer's income tax return (including extensions) for the 2007 taxable year.

Under section 5 of Rev. Proc. 2007–44, 2007–28 I.R.B. 54, the remedial amendment period with respect to § 1.401(a)–1(b)(2) and (3) will be extended to the end of a plan's applicable 5-year or 6-year remedial amendment cycle (described in section 6.01 of Rev. Proc. 2007–44) that includes the date on which the remedial amendment period would otherwise end, if, by that date, the plan sponsor either adopts a good faith interim amendment to comply with § 1.401(a)–1(b)(2) and (3) or reasonably and in good faith determines that no amendment is required. Under

§ 1.401(b)–1(e)(3), the filing of a determination letter application within a plan's remedial amendment period tolls the running of the period until the end of 91 days after the determination letter is issued.

Section 1.411(d)–4, Q&A–12, of the 2007 regulations provides an exception to the anti-cutback rules of § 411(d)(6) for conforming amendments during a transitional period that ends on the last day of the plan's applicable remedial amendment period under § 1.401(b)–1. This relief from the anti-cutback rules is limited to the elimination, as a result of an amendment that raises the plan's normal retirement age from one that is inappropriately low to one that satisfies the requirements of § 1.401(a)–1(b)(2), of a participant's right to an in-service distribution at the earlier age. In order to comply with § 411(a) and 411(d)(6), a plan subject to § 411 for which the normal retirement age has been raised to comply with the 2007 regulations must ensure that a participant who became or would have become eligible for payment of benefits at the normal retirement age under the prior plan terms, and who has severed from employment with the employer or employers maintaining the plan, continues to be eligible for payment at the same age and in at least the same amount as under the prior plan terms with respect to benefits accrued prior to the applicable amendment date (within the meaning of § 1.411(d)–3(g)(4)).

Notice 2007–3, 2007–2 I.R.B. 254, contains the 2006 Cumulative List of Changes in Plan Qualification Requirements. This notice provides that the 2007 regulations (which are listed as item 2 in Part V of the notice) will be taken into account in the Service's review of individually designed and multiple employer plans that are submitted for determination letters, and pre-approved defined benefit plans that are submitted for opinion or advisory letters, between February 1, 2007 and January 31, 2008 ("the Cycle B submission period").

B. Impact of Presumption under the 2007 Regulations that Normal Retirement Age Less than Age 55 is not Reasonable

As described above, § 1.401(a)–1(b)(2)(iv) provides that a normal retirement age below age 55 is presumed to be earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed, unless the Commissioner determines otherwise under the facts and circumstances. Some plan sponsors have expressed concern to the Service and Treasury that, although they believe they will be able to demonstrate that their plan's definition of normal retirement age of less than age 55 satisfies the requirements of the 2007 regulations, until they receive a determination to that effect from the Service, the presumption under the regulations that the plan does not satisfy those requirements creates uncertainty. This is of particular concern to sponsors of plans that provide in-service distributions upon attainment of normal retirement age because, if the plan is required to be amended to raise the normal retirement age retroactively, in-service distributions made between the effective date and adoption date of the amendment would not satisfy the plan qualification requirements.

Sponsors of plans that do not provide in-service distributions upon attainment of normal retirement age have also expressed concerns about the immediate effective date of the 2007 regulations. However, uncertainty as to how a plan must be amended to comply with the 2007 regulations may have less effect on current plan operations for these plans, because a plan that does not provide in-service distributions upon attainment of normal retirement age may be amended to retroactively raise the normal retirement age in a way that is consistent with the plan's operation between the effective date and adoption date of the amendment. For example, such a plan may be amended to give participants who sever employment with a vested accrued benefit the right to receive an early retirement benefit upon attainment of the pre-amendment normal retirement age (or severance from employment, if later) in the same amount that would have been paid as the normal retirement benefit if the plan had not been amended. *See* § 1.411(d)–4, Q&A–12(b), for an example of a plan amendment that retroactively raises the plan's normal retirement age without violating § 411(d)(6) or other plan qualification requirements.

The concerns that have been expressed by plan sponsors are illustrated in the case of some plans that define normal retirement age as the earlier of a fixed age or the completion of a lengthy period of service (*e.g.*, 30 years). The sponsors of these plans have asserted that the normal retirement age under their plan is the typical retirement age for the industry in which the covered workforce is employed, even though it is possible for participants to attain the normal retirement age as early as age 47 or 48. These sponsors have stated that the immediate effective date of the 2007 regulations may lead employers, particularly those that sponsor plans that offer in-service distributions upon attainment of normal retirement age, to take unnecessary action if the plan is later found upon review by the Service to have a normal retirement age that is reasonably representative of the industry in which the covered workforce is employed.

In response to these concerns, the Service and Treasury are providing the temporary relief described below in Part III of this notice.

III. Relief Provided

Two forms of relief are provided, as described in sections A and B, below. The relief is available to plans that meet the eligibility requirements in section A or B, and that might otherwise be required to be amended to raise the plan's normal retirement age effective before the first day of the first plan year beginning after June 30, 2008, in order to satisfy the 2007 regulations. Thus, the relief does not apply to governmental plans, but it does apply to a plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on May 22, 2007, if the first plan year beginning after the last of the agreements terminates (determined without regard to any extension thereof) begins before July 1, 2008.

A. Temporary Relief for Plans with Normal Retirement Age Lower Than Age 62

The Service will not propose to disqualify a plan solely because the plan fails to satisfy the requirements of § 1.401(a)–1(b)(2) and (3) if the plan satisfies the following conditions:

1. The plan, immediately prior to May 22, 2007, provided a definition of nor-

mal retirement age that was earlier than age 62.
2. No possible plan participant hired at age 18 or older could attain the plan's normal retirement age before the age of 40.
3. Unless the plan sponsor reasonably and in good faith determines that no amendment is necessary, the sponsor adopts a good faith interim amendment to comply with § 1.401(a)–1(b)(2) and (3) effective no later than the first day of the first plan year beginning after June 30, 2008, and the plan is operated in compliance with such amendment as of the amendment's effective date.
4. The plan sponsor adopts the interim amendment by the later of (a) the last day of the first plan year beginning after June 30, 2008, or (b) the due date (including extensions) for filing the employer's income tax return for the employer's taxable year that includes the first day of the first plan year beginning after June 30, 2008. (In the case of a tax exempt employer, *see* section 5.06(2) of Rev. Proc. 2007–44 for the rules for determining the employer's tax filing deadline for this purpose.)

In addition, relief is provided for the rare and unusual circumstance where the plan sponsor has acted in good faith in making a determination that the plan's normal retirement age is not earlier than the typical retirement age for the industry in which the covered workforce is employed, but the plan's normal retirement age actually is earlier than the typical retirement age for the industry in which the covered workforce is employed. In such a case, if the plan sponsor applies for a determination letter within the applicable remedial amendment cycle, the Service will require corrective action to be taken prospectively only from the date of issuance of the determination letter, so that the plan's normal retirement age will not be required to be raised retroactively. For this purpose, "the applicable remedial amendment cycle" is the plan's remedial amendment cycle under Rev. Proc. 2007–44 that includes the interim amendment deadline determined under condition 4, above. Any plan amendment that is determined to be necessary to comply with § 1.401(a)–1(b)(2) and (3) will not be required to be adopted earlier than the 91st day after the date of the Service's determination letter. The relief under this paragraph applies only if the plan's normal retirement age is not earlier than age 55.

B. Temporary Presumption of Reasonableness for Plans with Normal Retirement Age Lower Than Age 55

Eligible plans with a normal retirement age lower than 55 will temporarily be accorded the same presumption as plans with a normal retirement age between age 55 and 62. Thus, for periods prior to the date on which the Service rules on an eligible plan's normal retirement age, the plan sponsor's good faith determination of the typical retirement age for the industry in which the covered workforce is employed will generally be given deference, assuming that the determination is reasonable under the facts and circumstances.

A plan is eligible for the relief under this Part III.B if it satisfies the following conditions:

1. The plan, immediately prior to May 22, 2007, provided a definition of normal retirement age that was earlier than age 55.
2. No possible plan participant hired at age 18 or older could attain the plan's normal retirement age before the age of 40.
3. The plan sponsor submits a request for a letter ruling on whether its definition of normal retirement age satisfies the standard in the 2007 regulations, in accordance with the procedures described in Part IV below, by June 30, 2008.

If the Service determines during the ruling process that the plan's normal retirement age does not reasonably represent the typical retirement age for the industry in which the covered workforce is employed, the Service will require corrective action to be taken prospectively only from the date of issuance of the ruling letter, so that the plan's normal retirement age will not be required to be raised retroactively. In addition, for purposes of § 401(b) and the regulations thereunder, the letter ruling request will be treated as an application for a determination letter on the qualification of the plan, so that any plan amendment that is determined to be necessary to comply with § 1.401(a)–1(b)(2) and (3) will not be required to be adopted earlier than the 91st day after the date of the Service's ruling.

IV. Application Procedures for Letter Ruling on Definition of Normal Retirement Age

An application for a letter ruling as to whether a plan's normal retirement age reasonably represents the typical retirement age for the industry in which the covered workforce is employed is to be made in accordance with the procedures governing letter rulings requests in Rev. Proc. 2007–4, 2007–1 I.R.B. 118. The request must include the user fee for a letter ruling under section 6.01(10) of Rev. Proc. 2007–8, 2007–1 I.R.B. 230.

The statement and analysis of facts of the letter ruling request must:

1. Indicate whether and when a determination letter for the plan with respect to the plan's current remedial amendment cycle has been or will be filed.
2. Describe the industry in which the covered workforce is generally employed.
3. Identify the sources and date of compilation of data that was used in determining the typical retirement age for the industry, which may include data concerning employee retirement from the plan sponsor. (It is expected that the data will include the actual ages of termination of employment of career employees, *i.e.*, employees whose principal career has been in the employment of the plan sponsor.)
4. Present and analyze the data the plan sponsor used to determine the typical retirement age.
5. Describe any other relevant information (whether or not used by the plan sponsor in determining the typical retirement age).

The Service reserves the right to request any other information it considers necessary.

V. Application of Accrual Rules in the Case of Normal Retirement Age Based on Years of Service

The 2007 regulations do not provide a safe harbor or other guidance with respect

to a normal retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service. The Service and Treasury expect that a plan under which a participant's normal retirement age changes to an earlier date upon completion of a stated number of years of service typically will not satisfy the vesting or accrual rules of § 411. See, *e.g.*, § 1.411(b)–1(b)(2)(ii)(F). The relief described in Part III of this notice is limited to compliance with the 2007 regulations and thus, for example, does not extend to any violation of § 411(a)(1) or 411(b)(1) that may arise from a plan's definition of normal retirement age as other than a stated age.

The fact that plans are limited in their ability to provide a normal retirement age that is based on completion of a stated number of years of service does not mean that plans cannot provide benefits that are based on completion of a stated number of years of service. For example, an early retirement benefit, including an unreduced early retirement benefit, is permitted to be conditioned on completion of a stated number of years of service (such as 30 years of service). However, an early retirement benefit is generally only permitted to commence with an annuity starting date that is after severance from employment (except to the extent permitted under § 401(a)(36), as added by the Pension Protection Act of 2006, Pub. L. 109–280).

VI. Request for Comments

Sponsors of governmental plans and other plans not subject to the requirements of § 411 are asked to submit comments on whether normal retirement age under such a plan may be based on years of service. Comments are requested on whether and how a pension plan with a normal retirement age conditioned on the completion of a stated number of years of service satisfies the requirement in § 1.401(a)–1(b)(1)(i) that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules. Comments should be submitted by November 25, 2007, to CC:PA:LPD:PR (Notice 2007–69), Room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2007–69), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. Alternatively, comments may be submitted via the Internet at *Notice.comments@irscounsel.treas.gov*. Please include "Notice 2007–69" in the subject line of any electronic communication. All materials submitted will be available for public inspection and copying.

VII. Effect on Other Documents

Rev. Proc. 2007–4 is modified.

Notice 2007–3 is modified to provide that the 2007 regulations will be taken into account in the Service's review of a plan that is submitted for a determination letter during the Cycle B submission period only if the plan is an individually designed or a multiple employer plan that, by its terms, is not eligible for the relief in this notice. Thus, for example, the 2007 regulations will be taken into account in the Service's review of an individually designed or a multiple employer plan that is submitted during the Cycle B submission period if, under the plan, a participant hired at age 18 or older could attain the plan's normal retirement age before the age of 40. The 2007 regulations will also be taken into account in the Service's review of pre-approved defined benefit plans that are submitted for opinion or advisory letters during the Cycle B submission period.

Drafting Information

The principal authors of this notice are Diane S. Bloom and James P. Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans taxpayer assistance answering service Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time at 1–877–829–5500 (a toll-free call) or e-mail *RetirementPlanQuestions@irs.gov*.

Modification of Notice 2003–81

Notice 2007–71

This notice modifies and supplements Notice 2003–81, 2003–2 C.B. 1223, by correcting a statement in the "Facts" portion of Notice 2003–81.

BACKGROUND

On December 4, 2003, the Internal Revenue Service ("Service") and the Treasury Department ("Treasury") published Notice 2003–81, which described a tax avoidance transaction involving offsetting foreign currency options and identified such transaction and those substantially similar to it as listed transactions for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 301.6111–2(b)(2) and 301.6112–1(b)(2) of the Procedure and Administration Regulations.

In the transaction described in Notice 2003–81, a taxpayer pays premiums to purchase a call option and a put option (the purchased options) on a foreign currency in which positions are traded through regulated futures contracts. The purchased options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a loss position in one of the two purchased options. The taxpayer also receives premiums for writing a call option and a put option (the written options) on a different foreign currency in which positions are not traded through regulated futures contracts. The taxpayer takes the position that the written options are neither foreign currency contracts within the meaning of § 1256(g)(2)(A) nor § 1256 contracts within the meaning of § 1256(b). The written options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a gain position in one of the two written options.

The values of the two currencies underlying the purchased and written options (i) historically have demonstrated a very high positive correlation with one another, or (ii) officially have been linked to one an-

other, such as through the European Exchange Rate Mechanism (ERM II). Thus, as the currencies change in value, the taxpayer reasonably expects to have the following potential gains and losses in substantially offsetting positions: (1) a loss in a purchased option and a gain in a written option; and (2) a gain in a purchased option and a loss in a written option. At any time, the taxpayer's loss in the purchased option position that has declined in value may be more or less than the taxpayer's gain in the offsetting written option position that has appreciated in value. Similarly, the taxpayer's gain in the remaining purchased option position may be more or less than the taxpayer's loss in the remaining written option position. A material pre-tax profit or rate of return, or both, on the transaction is possible but unlikely.

The taxpayer assigns to a charity the purchased option that has a loss. The charity also assumes the taxpayer's obligation under the offsetting written option that has a gain. The premium received on that written option is not assigned but is retained by the taxpayer. As with all written options, the amount of gain on the option is limited to the premium received for the option. In the same tax year, the taxpayer may dispose of the remaining purchased option and offsetting written option.

Because the taxpayer takes the position that the purchased option assigned to the charity is a § 1256 contract, the taxpayer relies on § 1256(c) and Greene v. United States, 79 F.3d 1348 (2d Cir. 1996) to mark to market the purchased option when the option is assigned to the charity and to recognize a loss at that time. In contrast, because the taxpayer takes the position that the assumed written option is not a § 1256 contract, the taxpayer claims not to recognize gain attributable to the option premium. Specifically, the taxpayer claims that the charity's assumption of the option obligation does not cause the taxpayer to recognize gain and that the taxpayer also does not recognize gain either at the time the option expires or terminates or at any other time.

ANALYSIS

Although as a general matter the "Facts" portion of Notice 2003–81 correctly describes the transaction at issue, it includes an erroneous conclusion of law. The second sentence in the "Facts" portion of Notice 2003–81 states: "The currency is one in which positions are traded through regulated futures contracts, and the purchased options, therefore, are foreign currency contracts within the meaning of § 1256(g)(2)(A) of the Internal Revenue Code and § 1256 contracts within the meaning of § 1256(b)."

This sentence should have stated "The taxpayer takes the position that the purchased options are foreign currency contracts within the meaning of § 1256(g)(2)(A) of the Internal Revenue Code and § 1256 contracts within the meaning of § 1256(b)." The Service and Treasury do not believe that foreign currency options, whether or not the underlying currency is one in which positions are traded through regulated futures contracts, are foreign currency contracts as defined in § 1256(g)(2), and intend to challenge any such characterization by taxpayers.

Section 1256(g)(2)(A) defines a foreign currency contract, in part, as a contract that requires delivery of, *or the settlement of which depends on the value of*, certain foreign currencies. The original statutory definition, however, did not allow for cash settlement and required actual delivery of the underlying foreign currency in all circumstances. Options, by their nature, only require delivery if the option is exercised. Section 102 of the Tax Reform Act of 1984, P.L. 98–369, 1984–3 (Vol. 1) C.B. 128, added the clause "or the settlement of which depends on the value of." There is no indication, however, that Congress intended by this addition to extend the definition of "foreign currency contract" to foreign currency options. That conclusion is confirmed by the legislative history to § 988(c)(1)(E), enacted by the Technical and Miscellaneous Revenue Act of 1988, P.L. 100–647, 1988–3 C.B. 377–380, which indicates that a foreign currency option is not a foreign currency contract as defined in § 1256(g)(2).

Subject to the following, § 7805(b) relief is granted to taxpayers that adopted an accounting method in reasonable reliance on Notice 2003–81 to treat over-the-counter foreign currency options as foreign currency contracts as defined in § 1256(g)(2). Section 7805(b) relief is not granted with respect to options entered into in transactions that are the same or substantially the same as those described in Notice 2003–81. Further, § 7805(b) relief is not granted with respect to options entered into in any transaction identified as a listed transaction for purposes of §§ 1.6011–4(b)(2), 301.6111–2(b)(2) and 301.6112–1(b)(2).

The principal authors of this notice are Mark E. Erwin of the Office of Associate Chief Counsel (International) and Patrick E. White of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Mark E. Erwin at (202) 622–3870 or Patrick E. White at (202) 622–3920 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Withdrawal of Proposed Regulations

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

REG–121475–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and withdrawal of proposed regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9339) relating to the Federal income tax treatment of qualified zone academy bonds. This document contains proposed regulations that provide guidance to state and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds on the program requirements for qualified zone academy bonds. The regulations implement the amendments to section 1397E of the Internal Revenue Code (Code) and provide guidance on the maximum term, permissible use of proceeds, and remedial actions for qualified zone academy bonds. The text of those regulations also serves as the text of these proposed regulations. This document also withdraws proposed regulations (REG–121475–03, 2004–1 C.B. 793) published March 26, 2004.

DATES: Written or electronic comments and requests for a public hearing must be received by October 15, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–121475–03), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–121475–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–121475–03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Zoran Stojanovic, (202) 622–3980; concerning submissions of comments and/or requests for a hearing, Richard A. Hurst, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these proposed regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1908. Responses to this collection of information are required to obtain or retain a benefit. This collection of information is required by the IRS to verify compliance with section 1397E. Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by September 14, 2007. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §1.1397E–1(h). This collection of information is required by the IRS to verify compliance with section 1397E. This information will be used to identify issuers of qualified zone academy bonds that have established a defeasance escrow as a remedial action taken because of failure to satisfy certain requirements of section 1397E. The collection of information is required to obtain or retain a benefit. The likely respondents are states or local governments that issue qualified zone academy bonds.

Estimated total annual reporting burden: 3 hours.

Estimated average annual burden hours per respondent: 30 minutes.

Estimated number of respondents: 6.

Estimated annual frequency of responses: varies.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to section 1397E. The temporary regulations amend the final regulations adopted September 26, 2000 (T.D. 8903, 2000–2 C.B. 352 [65 FR 57732]), and provide guidance to state and local governments that issue qualified zone academy bonds and to bank, insur-

ance companies, and other taxpayers that hold those bonds. The temporary regulations provide guidance on the program requirements for qualified zone academy bonds. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rule rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. It is estimated that each year six issuers of QZABs will be required to report the establishment of a defeasance escrow, and the average estimated burden of each such reporting is 30 minutes. In addition, the establishment of a defeasance escrow need only be reported once. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Timothy L. Jones and Zoran Stojanovic, Office of Division Counsel/Associate Chief Counsel, IRS (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Withdrawal of Proposed Regulations

Under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–121475–03) published in the **Federal Register** on March 26, 2004 (69 FR 15747) is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority 26 U.S.C. 7805 * * *

Section 1.1397E–1 also issued under 26 U.S.C. 1397E. * * *

Par. 2. Section 1.1397E–1 is amended by revising paragraphs (a), (d), (h), (i), (j), (k), (l), and (m) to read as follows:

§1.1397E–1 Qualified zone academy bonds.

(a) [The text of the proposed amendment to §1.1397E–1(a) is the same as the text of §1.1397E–1T(a) published elsewhere in this issue of the Bulletin].

* * * * *

(d) [The text of the proposed amendment to §1.1397E–1(d) is the same as the text of §1.1397E–1T(d) published elsewhere in this issue of the Bulletin].

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(h) [The text of the proposed amendment to §1.1397E–1(h) is the same as the text of §1.1397E–1T(h) published elsewhere in this issue of the Bulletin].

(i) [The text of the proposed amendment to §1.1397E–1(i) is the same as the text of §1.1397E–1T(i) published elsewhere in this issue of the Bulletin].

(j) [The text of the proposed amendment to §1.1397E–1(j) is the same as the text of §1.1397E–1T(j) published elsewhere in this issue of the Bulletin].

(k) [The text of the proposed amendment to §1.1397E–1(k) is the same as the text of §1.1397E–1T(k) published elsewhere in this issue of the Bulletin].

(l) [The text of the proposed amendment to §1.1397E–1(l) is the same as the text of §1.1397E–1T(l) published elsewhere in this issue of the Bulletin].

(m) [The text of the proposed amendment to §1.1397E–1(m) is the same as the text of §1.1397E–1T(m)(1) and (m)(2) published elsewhere in this issue of the Bulletin].

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 16, 2007, 72 F.R. 38802)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-72

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007

Name	Address	Designation	Date of Reinstatement
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007

Name	Address	Designation	Date of Suspension
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007

Name	Address	Designation	Date of Suspension
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007

Name	Address	Designation	Date of Suspension
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Unified Rule for Loss on Subsidiary Stock; Correction

Announcement 2007–74

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG–157711–02, 2007–8 I.R.B. 537) that was published in the **Federal Register** on Tuesday, January 23, 2007 (72 FR 2964). These regulations apply to corporations filing consolidated returns. The regulations implement aspects of the repeal of the *General Utilities* doctrine by redetermining members' bases in subsidiary stock and requiring certain reductions in subsidiary stock basis on a transfer of the stock. The regulations promote the clear reflection of income by redetermining members' bases in subsidiary's stock and reducing the subsidiary's attributes to prevent the duplication of loss, and they also, provide guidance limiting the application of section 362(e)(2) with respect to transactions between members of a consolidated group.

FOR FURTHER INFORMATION CONTACT: Theresa Abell (202) 622–7700 or Phoebe Bennett (202) 622–7770 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–157711–02) that is the subject of these corrections is under sections 358, 362(e)(2) and 1502 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–157711–02) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–157711–02), that is the subject of FR Doc. 07–187, is corrected as follows:

1. On page 2964, column 2, in the preamble, under the paragraph heading "Paperwork Reduction Act", eighth paragraph of the column, line 3, the language "13(e)(4)(v) and 1.1502–36(d)(7). The" is corrected to read "13(e)(4)(v) and 1.1502–36(d)(6). The".

2. On page 2964, column 3, in the preamble, under the paragraph heading "Background", second paragraph of the column, line 10, the language "*v. United States*, 255 F.3d 1357 (2001)," is corrected to read "*v. United States*, 255 F.3d 1357 (Fed. Cir. 2001),".

3. On page 2965, column 1, in the preamble, under the paragraph heading "2. The Administrative Response to GU Repeal: §1.1502–20.", first paragraph, line 2 from bottom of the paragraph, the language "determine adjustments to member's" is corrected to read "determine adjustments to members'".

4. On page 2972, column 1, in the preamble, under the paragraph heading "2. Hybrid Tracing-Presumptive Model: Asset Tracing.", first paragraph, line 3, the language "presumption approach that would" is corrected to read "presumptive approach that would".

5. On page 2972, column 2, in the preamble, the paragraph heading "3. Presumption-Based Models" is corrected to read "3. Presumptive-Based Models.".

6. On page 2975, column 1, in the preamble, under the paragraph heading "d. *Netting of items from different tax periods.*", first paragraph, line 6, the language, "investments were not. The IRS and" is corrected to read "investment adjustments were not. The IRS and".

7. On page 2975, column 1, in the preamble, under the paragraph heading "d. *Netting of items from different tax periods.*", second paragraph, line 8, the language, "account by the group. Thus, IRS and" is corrected to read "account by the group. Thus, the IRS and".

8. On page 2975, column 2, in the preamble under the paragraph heading "e. *Summary and conclusions.*", second paragraph, line 12 from the bottom of the paragraph, the language "administrative and other concerns" is corrected to read "administrative burden and other concerns".

9. On page 2977, column 1, in the preamble, under the paragraph heading "*E. Noneconomic and Duplicated Loss From Investment Adjustment System.*", first paragraph, line 2, the language "preamble, IRS and Treasury Department" is corrected to read "preamble, the IRS and Treasury Department".

10. On page 2978, column 3, under paragraph heading "1. Overview.", third paragraph of the column, line 4 from the bottom of the paragraph, the language "implement a loss limitation approach" is correct to read "implements a loss limitation approach".

11. On page 2980, column 1, under paragraph heading "4. The Attribute Reduction Rule.", second paragraph, lines 16 and 17, the language "the value of all of the S shares. Net the inside attributes generally has the same" is corrected to read "the value of all the S shares. The term net inside attributes generally has the same".

12. On page 2980, column 1, under paragraph heading "4. The Attribute Reduction Rule.", third paragraph, last line of the column, the language "stock loss for a later recognition (for" is corrected to read "stock loss for later recognition (for".

13. On page 2980, column 2, under paragraph heading "4. The Attribute Reduction Rule.", second paragraph of the column, lines 1 and 2 from bottom of the paragraph, the language "attributes are reduced reflects this principle." is corrected to read "attributes are reduced reflects these principles.".

14. On page 2980, column 3, under subparagraph heading "a. *Special rules applicable when S holds stock of lower-tier subsidiary.*", second paragraph, line 16, the language "inside attributes. For example, if P owns" is corrected to read "inside attributes. For example, assume P owns".

15. On page 2981, column 3, under subparagraph heading "b. *Election to reduce stock basis and/or reattribute loss.*", first paragraph of the column, line 22 from bottom of the paragraph, the language "transaction. Proposed regulations under" is corrected to read "transaction."

16. On page 2981, column 3, under subparagraph heading "b. *Election to reduce stock basis and/or reattribute loss.*", second paragraph, line 21 from bottom of the paragraph, the language "§1.1502–32 treat the reattributed" is corrected and

added with new paragraph to read "Proposed regulations under §1.1502–32 treat the reattributed ".

17. On page 2982, column 1, under subparagraph heading "6. Special Rules for Section 362(e)(2) Transaction.", second paragraph, lines 1 and 2 from bottom of the column, the language "under section 362(e)(2)(C) been made Similarly, to adjust for distortions" is corrected to read "under section 362(e)(2)(C) been made. Similarly, to adjust for distortions".

18. On page 2982, column 2, under subparagraph heading "6. Special Rules for Section 362(e)(2) Transaction.", second paragraph of the column, line 9 from the bottom of the paragraph, the language, "stock basis and net inside attributes that" is corrected to read "stock basis, net inside attributes, and value that".

19. On page 2983, column 2, under subparagraph heading "2. Suspension of Section 362(e)(2) for Intercompany Transactions.", last paragraph of the column, line 2 from bottom of the column, the language "investment adjustment system has not" is corrected to read "investment adjustment system has not eliminated".

20. On page 2984, column 2, under subparagraph heading "4. Application of Section 362(e)(2) to Intercompany Transactions.", first paragraph of the column, line 7 from the bottom of the paragraph, the language "attributes is applied to proportionately" is corrected to read "attributes is applied proportionately".

21. On page 2984, column 3, under subparagraph heading "5. Special Allocations Under §1.1502–32.", line 7 of the paragraph, the language "entirely to member's shares. In other" is corrected to read "entirely to members' shares. In other".

22. On page 2986, column 2, under subparagraph heading, "8. Retention of, and Nonsubstantive Revisions to, §1.1502–80(c).", third paragraph of the column, line 8 of the paragraph, the language "under the LDR and, since LDR no longer" is corrected to read "under the LDR and, since the LDR no longer".

23. On page 2986, column 3, under subparagraph heading, "8. Retention of, and Nonsubstantive Revisions to, §1.1502–80(c).", first paragraph of the column, line 2 of the column, the language "deduction. See, *In re Prudential Lines*," is corrected to read "deduction. See *In re Prudential Lines*,".

§1.1502–13 [Corrected]

24. On page 2988, column 1, §1.1502–13(e)(4)(ii)(C)(*2*), line 12 from bottom of the column, the language "otherwise is eliminated (other than" is corrected to read "otherwise eliminated (other than".

25. On page 2989, column 3, §1.1502–13(e)(4)(vi), *Example 3*.(iv), line 18 of the paragraph, the language "in §1.1502–32(b)(3)(iii)(B), and will effect P's" is corrected to read "in §1.1502–32(b)(3)(iii)(B), and will affect P's".

§1.1502–32 [Corrected]

26. On page 2991, column 3, §1.1502–32(b)(3)(iii)(C), line 3 from bottom of the paragraph, the language "**Federal Register**, see 1.1502–" is corrected to read "**Federal Register**, see §1.1502–".

27. On page 2991, column 3, §1.1502–32(b)(3)(iii)(D), line 3 from bottom of the paragraph, the language "see 1.1502–32(b)(3)(iii)(D) as contained" is corrected to read "see §1.1502–32(b)(3)(iii)(D) as contained".

28. On page 2991, column 3, §1.1502–32(c)(1)(i), line 2 from bottom of the column, the language "allocated to the shares of S's stock to" is corrected to read "allocated to the shares of S stock to".

29. On page 2993, column 1, §1.1502–32(c)(1)(ii)(A)(*2*) *Example*.(iv)(D), line7 from bottom of the column, the language "nondeductible basis recovery item if it is" is corrected to read "nondeductible basis recovery item if it were".

30. On page 2994, column 1, §1.1502–32(c)(2)(i), line 11, the language "that member's excess loss accounts and" is corrected to read "that member's excess loss account and".

31. On page 2994, column 2, §1.1502–32(c)(4)(i), line 3 of the paragraph, the language "share of S's preferred and common stock" is corrected to read "share of S preferred and common stock".

32. On page 2994, column 2, §1.1502–32(c)(4)(i), line 8 of the paragraph, the language "made by reallocating S's adjustments" is corrected to read "made by reallocating S stock adjustments".

33. On page 2994, column 2, §1.1502–32(c)(4)(i), last line of the paragraph, the language "of S's shares. * * *" is corrected to read "of the S shares. * * *".

§1.1502–35 [Corrected]

34. On page 2994, column 3, §1.1502–35(a), line 5 from bottom of the paragraph, the language "of April 1, 2006. For transfers and" is corrected to read "of April 1, 2007. For transfers and".

35. On page 2995, column 1, §1.1502–35(b)(3)(iii), line 4, the language "year of the group) is a noncapital," is corrected to read "year of the selling group) is a noncapital,".

§1.1502–36 [Corrected]

36. On page 2995, column 2, the language of the section heading "§1.1502–36 Loss on subsidiary stock." is corrected to read "§1.1502–36 Unified rule for loss on subsidiary stock.".

37. On page 2996, column 2, §1.1502–36(b)(1)(i), line 4 of the paragraph, the language "(b) reduce the extent to which there is" is corrected to read "(b) reduce (but do not increase) the extent to which there is".

38. On page 2997, column 1, §1.1502–36(b)(2)(iii)(A), line 2 of the paragraph, the language "Reallocations are made in a manner that" is corrected to read "All reallocations (both to and from members' shares of S stock) are made in a manner that".

39. On page 2997, column 2, §1.1502–36(b)(2)(iii)(B)(*2*)(*ii*) *Example*.(*iii*), line 6 from the bottom of the column, the language "would have tiered up to the M share P sold," is corrected to read "would have tiered up to the M share that P sold,".

40. On page 2999, column 2, §1.1502–36(b)(3) *Example 3*.(i), line 5 of the paragraph, the language "preferred shares to reflect their entitlement to" is corrected to read "preferred shares to reflect its entitlement to".

41. On page 2999, column 3, §1.1502–36(b)(3) *Example 3*.(ii)(C), line 8 of the paragraph, the language "Accordingly $25 of that amount is reallocated" is corrected to read " Accordingly, $25 of that amount is reallocated".

42. On page 3000, column 2, §1.1502–36(c)(6)(i), line 5 from the bot-

tom of the paragraph, the language "S1's investment adjustments increased" is corrected to read "S1's investment adjustments increase".

43. On page 3000, column 3, §1.1502–36(c)(6)(v) *Example.(ii)*, line 3 from the bottom of the paragraph, the language "the loss share stock of S1, the lowest-tier" is corrected to read "the loss share of S1 stock, the lowest-tier".

44. On page 3000, column 3, §1.1502–36(c)(6)(v) *Example.(iii)*, line 3 from the bottom of the paragraph, the language "recognized on the transfer of S3 tiers up to" is corrected to read "recognized on the transfer of S3 stock tiers up to".

45. On page 3001, column 3, §1.1502–36(c)(8) *Example 1.(i)*(C), line 13 of the paragraph, the language "recognized on the sale of Asset 1. Thus the" is corrected to read "recognized on the sale of Asset 1. Thus, the".

46. On page 3001, column 3, §1.1502–36(c)(8) *Example 1.(ii)*, line 5 from the bottom of the paragraph, the language "Asset 1 to $0) Because the net positive" is corrected to read "Asset 1 to $0). Because the net positive".

47. On page 3002, column 3, §1.1502–36(c)(8) *Example 1.(iv)*(B), line 4 of the paragraph, the language "there redetermination would change no" is corrected to read "redetermination would change no".

48. On page 3003, column 2, §1.1502–36(c)(8) *Example 4.(ii)*, lines 4 through 10 of the column, the language "Because the net positive adjustment includes items of income (and not just gain), the analysis of the application of this paragraph (c) is the same here as in paragraph (i)(C) of this *Example 4*. Furthermore, the analysis of the application of this paragraph (C) would also be the same if the $60 loss carryover were subject to a section 382 limitation from a prior ownership change, and if, instead, it would subject to the limitation in §1.1502–" is corrected to read "The analysis of the application of this paragraph (c) is the same here as in paragraph (i)(C) of this *Example 4*. Furthermore, the analysis of the application of this paragraph (c) would also be the same if the $60 loss carryover were subject to a section 382 limitation from a prior ownership change, if, instead, it were subject to the limitation in §1.1502–".

49. On page 3003, column 2, §1.1502–36(c)(8) *Example 5.(i)*, lines 7 through 10 of the paragraph, the language "December 31, year 1, P sells one of its shares, Share 1, for $20. After applying and giving effect to all generally applicable rules of law (other than this section), P's basis in its Share" is corrected to read "December 31, year 1, P sells one of its S shares, Share 1, for $20. After applying and giving effect to all generally applicable rules of law (other than this section), P's basis in Share".

50. On page 3003, column 2, §1.1502–36(c)(8) *Example 5.(iii)*, line 6 from the bottom of the paragraph, the language "($100 from the sale of the asset), and Share" is corrected to read "($100 from the sale of Asset), and Share".

51. On page 3004, column 3, §1.1502–36(c)(8) *Example 7.(i)*, line 8 from the bottom of the paragraph, the language "basis in S1 under §1.1502–32 by $40 (to" is corrected to read "basis in the S1 share under §1.1502–32 by $40 (to".

52. On page 3006, column 2, §1.1502–36(d)(5)(ii)(B)(*3*), line 3 from the bottom of the paragraph, the language "extent necessary to reduce the bases of" is corrected to read "extent necessary to reduce the basis of".

53. On page 3006, column 2, §1.1502–36(d)(5)(ii)(B)(*4*), line 2 from the bottom of the paragraph, the language "the basis of such shares without" is corrected to read "the bases of such shares without".

54. On page 3007, column 1, §1.1502–36(d)(6)(ii)(B), line 5 from the bottom of the paragraph, the language "immediately tier up (under the" is corrected to read "immediately tiers up (under the".

55. On page 3007, column 3, §1.1502–36(d)(6)(iv), line 4 of the paragraph, the language "all members' basis in loss shares of S" is corrected to read "all members' bases in loss shares of S".

56. On page 3007, column 3, §1.1502–36(d)(7) *Example 1.(i)*(B), line 3 of the paragraph, the language "under paragraph (b) of this section either" is corrected to read "under paragraph (b) of this section because".

57. On page 3008, column 1, §1.1502–36(d)(7) *Example 1.(i)*(B), line 2 of the column, the language "disparity in the basis of the shares). See" is corrected to read "disparity in the bases of the shares). See".

58. On page 3009, column 2, §1.1502–36(d)(7) *Example 4.(i)*(A), line 4 of the column, the language "the $500 income earned). The sale is" is corrected to read "the $500 of income earned). The sale is".

59. On page 3010, column 2, §1.1502–36(d)(7) *Example 5.(i)*(C)(*3*), line 10 from the bottom of the paragraph, the language "the transaction ($50) over the sum of" is corrected to read "the transaction ($50) over the sum of the".

60. On page 3010, column 3, §1.1502–36(d)(7) *Example 5.(ii)*(C)(*4*), lines 15 to 21 of the paragraph, the language "reductions to share A and to share B under this paragraph (d) are reversed to restore the basis of each share to $12.50. Thus, $25 of the $27.50 attribute reduction applied to reduce the basis of share A and $25 of the $47.50 attribute reduction applied to reduce the basis of share B are reversed, restoring the" is corrected to read "reductions to Share A and to Share B under this paragraph (d) are reversed to restore the basis of each share to $12.50. Thus, $25 of the $27.50 attribute reduction applied to reduce the basis of Share A and $25 of the $47.50 attribute reduction applied to reduce the basis of Share B are reversed, restoring the".

61. On page 3011, column 2, §1.1502–36(d)(7) *Example 6.(ii)*(B), line 2 from the bottom of the column, the language "basis in subsidiary stock under the principles" is corrected to read "bases in subsidiary stock under the principles".

62. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.(ii)*(B), line 2 from the top of the column, the language "the transaction the sale is not subject to" is corrected to read "the transaction, the sale is not subject to".

63. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.(ii)*(C), line 3 of the paragraph, the language "*this section*). The next highest tier transfer is" is corrected to read "*this section*). The next higher tier transfer is".

64. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.(ii)*(C), line 8 from the bottom of the paragraph, the language "of the transferred Share E minus the $20" is corrected to read "of the transferred share E minus the $20".

65. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.*(*ii*)(D)(*1*), line 6 from the bottom of the paragraph, the language "basis in its asset)) minus S's liability ($20)." is corrected to read "basis in its asset))) minus S's liability ($20).".

66. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.*(*ii*)(D)(*2*), lines 5 to 6 from the bottom of the paragraph, the language "applied to reduce the basis of share E because share E was transferred in a transaction in" is corrected to read "applied to reduce the basis of share E, because share E was transferred in a transfer in".

67. On page 3011, column 3, §1.1502–36(d)(7) *Example 6.*(*ii*)(D)(*3*), line 3 from the bottom of the column, the language "apportioned to or applied to reduced the" is corrected to read "apportioned to or applied to reduce the".

68. On page 3012, column 3, §1.1502–36(d)(7) *Example 7.*(*iii*)(C)(*3*), line 16 of the paragraph, the language "reducing the basis of both assets to $0." is corrected to read "reducing the basis of each asset to $0.".

69. On page 3012, column 3, §1.1502–36(d)(7) *Example 7.*(*iii*)(C)(*3*), line 2 from the bottom of the paragraph, the language "attribute reduction amount is disregarded has" is corrected to read "attribute reduction amount is disregarded and has".

70. On page 3013, column 1, §1.1502–36(d)(7) *Example 8.*(*i*)(E), line 5 of the paragraph, the language "basis in the S shares by the full attribute" is corrected to read "bases in the S shares by the full attribute".

71. On page 3013, column 2, §1.1502–36(d)(7) *Example 8.*(*i*)(E), line 7 of the paragraph, the language "transfer. The reduction of M's basis in the S" is corrected to read "transfer. The reduction of M's bases in the S".

72. On page 3014, column 1, §1.1502–36(d)(7) *Example 8.*(*ii*)(E), lines 2 through 5 of the paragraph, the language "are the same as paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M's basis in the S shares by the full attribute" is corrected to read "are the same as in paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M's bases in the S shares by the full attribute".

73. On page 3014, column 1, §1.1502–36(d)(7) *Example 8.*(*ii*)(F), is removed.

74. On page 3014, column 1, §1.1502–36(d)(7) *Example 8.*(*ii*)(G), is the newly designated paragraph (F).

75. On page 3014, column 2, §1.1502–36(d)(7) *Example 9.*(*i*), line 5 from the bottom of the column, the language "to P1 (the common parent of a consolidated" is corrected to read "to P1 (the common parent of a different consolidated".

76. On page 3014, column 3, §1.1502–36(d)(7) *Example 9.*(*ii*), line 7 from the bottom of the column, the language "computed and is applied to adjust the basis" is corrected to read "computed and is applied to adjust the bases".

77. On page 3015, column 1, §1.1502–36(d)(7) *Example 9.*(*iii*), line 1 of the paragraph, the language "(iii) *Transfers in next highest tier (loss*" is corrected to read "(iii) *Transfers in next higher tier (loss*".

78. On page 3015, column 3, §1.1502–36(d)(7) *Example 9.*(*iv*)(B)(*2*), line 30 from the bottom of the paragraph, the language "allocated amount is apportioned among other" is corrected to read "allocated amount is apportioned among the other".

79. On page 3017, column 1, §1.1502–36(e)(1), last line of the paragraph, the language "the section." is corrected to read "this section.".

80. On page 3017, column 2, §1.1502–36(e)(2)(iii), line 6 of the paragraph, the language "allocable portion of S's attributes has" is corrected to read "allocable portion of S's net inside attributes has".

81. On page 3017, column 2, §1.1502–36(e)(2)(iv) *Example.*(*i*)(A), line 11 of the paragraph, the language "basis of A1 would have been reduced by $80" is corrected to read "basis in Asset 1 would have been reduced by $80".

82. On page 3017, column 2, §1.1502–36(e)(2)(iv) *Example.*(*i*)(B), last line of the paragraph, the language "to this paragraph (c)." is corrected to read "to paragraph (c) of this section.".

83. On page 3018, column 1, §1.1502–36(f)(2), line 6 of the column, the language "dealers in securities) and 481" is corrected to read "dealers in securities) and section 481".

84. On page 3018, column 1, §1.1502–36(f)(4), lines 6 through 15 of the paragraph, the language "basis of shares of S2 stock under §1.1502–32 affect the investment adjustments made to the basis of the stock of S1. A subsidiary (S1) (and its shares of stock) is *lower tier* with respect to another subsidiary (S) (and its shares of stock) if investment adjustments made to the basis of shares of S1 stock affect the investment adjustments made to the basis of shares of S stock. The" is corrected to read "bases of shares of S2 stock under §1.1502–32 affect the investment adjustments made to the bases of shares of S1 stock. A subsidiary (S1) (and its shares of stock) is *lower tier* with respect to another subsidiary (S) (and its shares of stock) if investment adjustments made to the bases of shares of S1 stock affect the investment adjustments made to the bases of shares of S stock. The".

85. On page 3019, column 1, §1.1502–36(g)(2) *Example 3.*(*ii*), line 4 of the paragraph, the language "there is no disparity in the basis of the" is corrected to read "there is no disparity in the bases of the".

86. On page 3019, column 1, §1.1502–36(g)(2) *Example 4.*(*i*), lines 5 through 6 from the bottom of the paragraph, the language "equal basis that exceeds value. S owns Asset 1 with a basis that exceeds value and cash." is corrected to read "equal basis that exceeds value. S owns Cash and Asset 1 with a basis that exceeds value.".

87. On page 3019, column 1, §1.1502–36(g)(2) *Example 4.*(*ii*), line 4 of the paragraph, the language "there is no disparity in the basis of the" is corrected to read "there is no disparity in the bases of the".

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on June 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for June 7, 2007, 72 F.R. 31483)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)–1: General overview of taxability under an annuity contract purchased by a section 501(c)(3) organization or a public school.

T.D. 9340

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 31, 54 and 602

Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document promulgates final regulations under section 403(b) of the Internal Revenue Code and under related provisions of sections 402(b), 402(g), 402A, and 414(c). The regulations provide updated guidance on section 403(b) contracts of public schools and tax-exempt organizations described in section 501(c)(3). These regulations will affect sponsors of section 403(b) contracts, administrators, participants, and beneficiaries.

DATES: *Effective Date:* July 26, 2007.

Applicability Date: These regulations generally apply for taxable years beginning after December 31, 2008. However, see the "Applicability date" section in this preamble for additional information regarding the applicability of these regulations.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, John Tolleris, (202) 622–6060; concerning the regulations as applied to church-related entities, Robert Architect (202) 283–9634 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in §1.403(b)–10(b)(2)(i)(C) of these final regulations has been approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2068. Responses to this collection of information are required in order to provide certain benefits.

The estimated burden per respondent varies among the plan administrator/payor/recordkeeper, depending upon individual respondents' circumstances, with an estimated average of 4.1 hours. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

The collection of information in §1.403(b)–10(b)(2)(i)(C) of these final regulations was not contained in the prior notice of proposed rulemaking. For this reason, this additional collection of information has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2068. Comments concerning this additional collection of information should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503. Comments on the collection of information should be received by September 24, 2007. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see above);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The estimated burden per respondent varies among the plan administrator/payor/recordkeeper, depending upon individual respondents' circumstances, with an estimated average of 4.1 hours.

Books or records relating to a collection of information must be retained as long as their contents might become material in

the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Regulations (T.D. 6783, 1965–1 C.B. 180) under section 403(b) of the Internal Revenue Code (Code) were originally published in the **Federal Register** (29 FR 18356) on December 24, 1964. Those regulations provided guidance for complying with section 403(b), which had been enacted in 1958 in section 23(a) of the Technical Amendments Act of 1958, Public Law 85–866 (1958), relating to tax-sheltered annuity arrangements established for employees by public schools and tax-exempt organizations described in section 501(c)(3). Since 1964, additional regulations were issued under section 403(b) to reflect rules relating to certain eligible rollover distributions[1] and required minimum distributions under section 401(a)(9).[2] See §601.601(d)(2) relating to objectives and standards for publishing regulations, revenue rulings and revenue procedures in the Internal Revenue Bulletin.

On November 16, 2004, a notice of proposed rulemaking (REG–155608–02, 2004–2 C.B. 924) was published in the **Federal Register** (69 FR 67075) that proposed a comprehensive update of the regulations under section 403(b) (2004 proposed regulations), including: amending the 1964 and subsequent regulations to conform them to the numerous amendments made to section 403(b) by subsequent legislation, including section 1022(e) of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 829), Public Law 93–406; section 251 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) (96 Stat. 324, 529), Public Law 97–248; section 1120 of the Tax Reform Act of 1986 (TRA '86) (100 Stat. 2085, 2463), Public Law 99–514; section 1450(a) of the Small Business Job Protection Act of 1996 (SBJPA) (110 Stat. 1755, 1814), Public Law 104–188; and sections 632, 646, and 647 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (115 Stat. 38, 113, 126, 127), Public Law 107–16. The 2004 proposed regulations also included controlled group rules under section 414(c) for entities that are tax-exempt under section 501(a).

Following publication of the 2004 proposed regulations, comments were received and a public hearing was held on February 15, 2005. After consideration of the comments received, the 2004 proposed regulations are adopted by this Treasury decision, subject to a number of changes, some of which are summarized below in this preamble.

Section 403(b) was also amended by sections 811, 821, 822, 824, 826, and 829 of the Pension Protection Act of 2006 (PPA '06) (120 Stat. 780), Public Law 109–280. These final regulations reflect these amendments.

Sections 403(b) and 414(c) Statutory Provisions

Section 403(b) provides an exclusion from gross income for certain contributions made by specific types of employers for their employees and by certain ministers to specified types of funding arrangements. The employers are limited to public schools and section 501(c)(3) organizations. There are three categories of funding arrangements to which section 403(b) applies: (1) annuity contracts (as defined in section 401(g)) issued by an insurance company; (2) custodial accounts that are invested solely in mutual funds; and (3) retirement income accounts, which are only permitted for church employees and certain ministers. Except as otherwise indicated, an annuity contract, for purposes of these final regulations, includes a custodial account that is invested solely in mutual funds.

The exclusion applies to employer nonelective contributions (including matching contributions) and elective deferrals (other than designated Roth contributions) within the meaning of section 402(g)(3)(C) (which applies to section 403(b) contributions made pursuant to a salary reduction agreement). The exclusion applies only if certain requirements relating to availability, nondiscrimination, and distribution are satisfied. Section 403(b) arrangements may also include after-tax employee contributions.

Section 403(b)(1)(C) requires that the contract be nonforfeitable (except for the failure to pay future premiums), regardless of the type of contribution used to purchase the contract. Section 403(b)(1)(E) requires a section 403(b) contract purchased under a salary reduction agreement to satisfy the requirements of section 401(a)(30) relating to limitations on elective deferrals under section 402(g)(1). In addition, all contributions to a section 403(b) arrangement, when expressed as annual additions under section 415(c)(2), must not exceed the applicable limit of section 415.

Section 403(b)(5) provides that all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract for purposes of the requirements of section 403(b). Other aggregation rules apply both on an individual and aggregate basis. For example, the section 402(g) limitations on elective deferrals apply to all elective deferrals during the year with respect to an individual and the limitations of section 401(a)(30) apply to all elective deferrals made by an employer to that employer's plans with respect to an individual during the year. The contribution limitations of section 415 generally apply on an employer-by-employer basis.

Section 403(b)(12) requires a section 403(b) contract that provides for elective deferrals to make elective deferrals available to all employees (the universal availability rule) and requires other contributions to satisfy the general nondiscrimination requirements applicable to qualified plans. These rules are discussed further in this preamble under the heading "Section 403(b) Nondiscrimination and Universal Availability Rules."

A section 403(b) contract is also required to provide that it will satisfy the required minimum distribution requirements of section 401(a)(9), the incidental benefit requirements of section 401(a), and the rollover distribution rules of section 402(c).

Many section 403(b) arrangements of employers that are section 501(c)(3) organizations are subject to the Employee Retirement Income Security Act of 1974

[1] See T.D. 8619, 1995–2 C.B. 41, September 22, 1995 (60 FR 49199).

[2] See T.D. 8987, 2002–1 C.B. 852, April 17, 2002 (67 FR 18987).

(ERISA), which includes rules substantially identical to the rules for qualified plans, including rules parallel to the section 414(l) transfer rules, the section 401(a)(11) qualified joint and survivor annuity (QJSA) transferee plan rules, and the anti-cutback rules of section 411(d)(6) (which apply to transfers). See sections 204(g), 205, and 208 of ERISA. However, as discussed in this preamble under the heading "Interaction Between Title I of ERISA and Section 403(b) of the Code," Title I of ERISA does not apply to governmental plans, certain church plans, or a tax-exempt employer's section 403(b) program that is not considered to constitute the establishment or maintenance of an "employee pension benefit plan" under Title I of ERISA.

Section 414(c) authorizes the Secretary of the Treasury to issue regulations treating all employees of trades or businesses which are under common control as employed by a single employer.

Explanation of Provisions

Overview

Like the 2004 proposed regulations, these final regulations are a comprehensive update of the current regulations under section 403(b). These regulations replace the existing final regulations that were adopted in 1964 and reflect the numerous legal changes that have been made in section 403(b) since then and many of the positions that have been taken in interpretive guidance that has been issued under section 403(b).

As was noted in the preamble to the 2004 proposed regulations, the effect of the various amendments made to section 403(b) within the past 40 years has been to diminish the extent to which the rules governing section 403(b) plans differ from the rules governing other tax-favored employer-based retirement plans, including arrangements that include salary reduction contributions, such as section 401(k) plans and section 457(b) plans for state and local governmental entities. However, there remain significant differences between section 403(b) plans and section 401(a) and governmental section 457(b) plans. For example, section 403(b) is limited to certain specific employers and employees (namely, employees of a public school, employees of a section 501(c)(3) organization, and certain ministers) and to certain funding arrangements (namely, an insurance annuity contract, a custodial account that is limited to mutual fund shares, or a church retirement income account). Also, section 403(b) contains the universal availability requirement for section 403(b) elective deferrals and provides consequences for failing to satisfy certain of the section 403(b) rules (described in this preamble under the heading "Effect of a Failure to Satisfy Section 403(b)")[3] that differ in significant respects from the consequences applicable to qualified plans.

The final regulations, as did the 2004 proposed regulations, require the section 403(b) contract to satisfy both in form and operation the applicable requirements for exclusion. The final regulations also require that the contract be maintained pursuant to a written plan as described in the next section.

The final regulations, like the proposed regulations, provide rules under which tax-exempt entities are aggregated and treated as a single employer under section 414(c). These rules apply to plans referenced in sections 414(b), (c), (m), (o), and (t), such as plans qualified under section 401(a) or 403(a), as well as section 403(b) plans.

Comments on the 2004 proposed regulations raised a number of questions and concerns about:

- The requirement in the 2004 proposed regulations under which a section 403(b) contract would be required to be maintained pursuant to a written plan;
- The elimination of certain non-statutory exclusions that a section 403(b) plan was permitted to have under Notice 89–23, 1989–1 C.B. 654, for purposes of the universal availability rule;
- The elimination of Rev. Rul. 90–24, 1990–1 C.B. 97, which allowed a section 403(b) contract to be exchanged for another contract; and
- The controlled group rules under section 414(c) for entities that are tax-exempt under section 501(a).

These final regulations include a number of revisions to reflect the comments received, as described further in this preamble.

Written Plan Requirement

These regulations retain the requirement from the 2004 proposed regulations that a section 403(b) contract be issued pursuant to a written plan which, in both form and operation, satisfies the requirements of section 403(b) and these regulations. This requirement implements the statutory requirements of section 403(b)(1)(D), which provides that the contract must be purchased "under a plan" that satisfies the nondiscrimination requirements delineated in section 403(b)(12).

The existence of a written plan facilitates the allocation of plan responsibilities among the employer, the issuer of the contract, and any other parties involved in implementing the plan. Without such a central document for a comprehensive summary of responsibilities, there is a risk that many of the important responsibilities required under the statute and final regulations may not be allocated to any party. While a section 403(b) contract issued to an employee can provide for the issuer to perform many of these functions by itself, the contract cannot satisfy the function of setting forth the eligibility criteria for other employees, nor can the issuer by itself coordinate those Code requirements that depend on other contracts, such as the loan limitations under section 72(p). The issuer must rely on information or representations provided by either the employer or the employee for employment-based information that is essential for compliance with section 403(b) provisions, such as the limitations on elective deferrals in section 402(g) and the requirements of section 72(p)(2) for a plan loan that is not a taxable deemed distribution. In addition to providing a central locus to coordinate those functions, the maintenance of a written plan also benefits participants by providing a central document setting forth their rights and enables government agencies to determine whether the arrangements satisfy applicable law and, in particular, for

[3] Other differences between the rules applicable to section 403(b) plans and qualified plans include the following: the definition of compensation (including the five-year rule) in section 403(b)(3); the special section 403(b) catch-up elective deferral in section 402(g)(7); and the section 415 aggregation rules. An additional difference relates to when a severance from employment occurs for purposes of section 403(b) plans maintained by State and local government employers. See §1.403(b)–6(h) of these regulations.

determining which employees are eligible to participate in the plan.

The 2004 proposed regulations would have required that the section 403(b) plan include all of the material provisions regarding eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made. The proposed regulations would not have required that there be a single plan document. However, under the proposed regulations, the written plan requirement would be satisfied by complying with the plan document rules applicable to qualified plans.

Some comments raised concerns that the written plan requirement would impose additional administrative burdens. In response, the final regulations make a number of clarifications, including that the plan is permitted to allocate to the employer or another person the responsibility for performing functions to administer the plan, including functions to comply with section 403(b). Any such allocation must identify who is responsible for compliance with the requirements of the Code that apply based on the aggregated contracts issued to a participant, including loans under section 72(p) and the requirements for obtaining a hardship withdrawal under §1.403(b)–6 of these regulations.

Additional comments recommended that certain responsibilities be permitted to be allocated to employees. The IRS and Treasury Department have concluded that it is generally inappropriate to allocate these responsibilities to employees for a number of reasons. First, employees often lack the expertise to systematically meet these responsibilities and may not recognize the importance of performing these actions (including not fully appreciating the tax consequences of failing to perform the responsibility). Second, an individual employee may have a self-interest in a particular transaction. In addition, while there are various factors that will often cause an employer or issuer to have an interest in procedures that ensure that the requirements of section 403(b) are satisfied (including income tax withholding requirements), an employee generally bears the income tax exposure and other risks of failing to comply with rules set forth in the plan. The IRS and Treasury Department believe it is important to prevent failures in advance so as to minimize the cases in which the adverse effects of a failure fall on the employee. See the discussion in this preamble under the heading "Contract Exchanges."

In response to comments, the final regulations clarify the requirement that the plan include all of the material provisions by permitting the plan to incorporate by reference other documents, including the insurance policy or custodial account, which as a result of such reference would become part of the plan. As a result, a plan may include a wide variety of documents, but it is important for the employer that adopts the plan to ensure that there is no conflict with other documents that are incorporated by reference. If a plan does incorporate other documents by reference, then, in the event of a conflict with another document, except in rare and unusual cases, the plan would govern. In the case of a plan that is funded through multiple issuers, it is expected that an employer would adopt a single plan document to coordinate administration among the issuers, rather than having a separate document for each issuer.

Finally, comments also indicated that, while section 403(b) contracts that are subject to ERISA are maintained pursuant to written plans, there may be a potential cost associated with satisfying the written plan requirement for those employers that do not have existing plan documents, such as public schools. To address this concern, the IRS and Treasury Department expect to publish guidance which includes model plan provisions that may be used by public school employers for this purpose. Because the requirement for a written plan will not go into effect until 2009 (see the discussion under the heading "Applicability date"), employers would be expected to adopt a written plan (including applicable amendments) no later than the applicability date of these regulations.

Contract Exchanges, Plan-to-Plan Transfers, and Purchases of Permissive Service Credit

The final regulations, like the 2004 proposed regulations, provide for three specific kinds of non-taxable exchanges or transfers of amounts in section 403(b) contracts. Specifically, under the final regulations, a non-taxable exchange or transfer is permitted for a section 403(b) contract if either: (1) it is a mere change of investment within the same plan (contract exchange); (2) it constitutes a plan-to-plan transfer, so that there is another employer plan receiving the exchange; or (3) it is a transfer to purchase permissive service credit (or a repayment to a defined benefit governmental plan). If an exchange or transfer does not constitute a change of investment within the plan, a plan-to-plan transfer, or a purchase of permissive service credit, the exchange or transfer would be treated as a taxable distribution of benefits in the form of property if the exchange occurs after a distributable event (assuming the distribution is not rolled over to an eligible retirement plan) or as a taxable conversion to a section 403(c) nonqualified annuity contract if a distributable event has not occurred. See the "Effect of a Failure to Satisfy Section 403(b)" section in this preamble for discussion of section 403(c) nonqualified annuity contracts. In any case in which a distributable event has occurred, a participant in a section 403(b) plan can always change the investment through a distribution and non-taxable rollover from a section 403(b) contract to an IRA annuity, as long as the distribution is an eligible rollover distribution. Note, however, that an IRA annuity cannot include provisions permitting participant loans. See sections 408(e)(3) and (4) and §§1.408–1(c)(5) and 1.408–3(c).

Any contract exchange, plan-to-plan transfer, or purchase of permissive service credit that is permitted under the final regulations is not treated as a distribution for purposes of the section 403(b) distribution restrictions (so that such an exchange or transfer may be made before severance from employment or another distribution event).

Contract Exchanges

Rev. Rul. 73–124, 1973–1 C.B. 200, and Rev. Rul. 90–24, 1990–1 C.B. 97, dealt with contract exchanges. Rev. Rul. 73–124 had allowed section 403(b) contracts to be exchanged, without income inclusion, if, pursuant to an agreement with the employer, the employee cashed in the first contract and immediately transmitted the cash proceeds for contribution to the successor contract to which all subsequent employer contributions would be made. This ruling was replaced by Rev. Rul.

90–24 which does not provide for the first contract to be cashed in but allows section 403(b) contracts to be exchanged, without income inclusion, so long as the successor contract includes distribution restrictions that are the same or more stringent than the distribution restrictions in the contract that is being exchanged.

The 2004 proposed regulations would have imposed additional restrictions on contract exchanges by limiting tax-free contract exchanges to situations in which the new contract is provided under the plan. The proposal was intended to improve compliance with the Code requirements that apply on an aggregated basis because, without coordination, it is difficult, if not impossible, for a plan to comply with those tax requirements. These requirements include certain distribution restrictions, including the rule that requires the suspension of deferrals for a plan that uses the hardship withdrawal suspension safe harbor rules for elective deferrals, and the section 72(p) rules for loans. In addition, these changes make it easier for employers to respond to an IRS inquiry or audit. For example, where assets have been transferred to an insurance carrier or mutual fund that has no subsequent connection to the plan or the employer, IRS audits and related investigations have revealed that employers encounter substantial difficulty in demonstrating compliance with hardship withdrawal and loan rules. These problems are particularly acute when an individual's benefits are held by numerous carriers. Such multiple contract issuers are commonly associated with plans in which Rev. Rul. 90–24 exchanges have occurred.

Commentators generally objected to the proposal to limit exchanges allowed under Rev. Rul. 90–24. They argued that such exchanges enable participants to change funding arrangements and claimed that these exchanges have generally been responsible for improved efficiency and lower cost in the section 403(b) market. Comments often included specific suggestions, such as limiting any restrictions on exchanges to active employees and effectuating compliance with loan restrictions by alternative methods, such as having the issuer report loans on, for example, a Form 1099–R (*Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*), or notify the employer about loans. Other comments included a recommendation that the employer be involved to ensure that the exchange is within the plan. Comments also suggested that a grandfather may be necessary for exchanges made before the applicability date of the restrictions imposed by the final regulations.

These final regulations include a number of changes to reflect these comments. The regulations allow contract exchanges with certain characteristics associated with Rev. Rul. 90–24, but under rules that are generally similar to those applicable to qualified plans.

Unlike the 2004 proposed regulations, these regulations permit an exchange of one contract for another to constitute a mere change of investment within the same plan, but only if certain conditions are satisfied in order to facilitate compliance with tax requirements. Specifically, the other contract must include distribution restrictions that are not less stringent than those imposed on the contract being exchanged and the employer must enter into an agreement with the issuer of the other contract under which the employer and the issuer will from time to time in the future provide each other with certain information. This includes information concerning the participant's employment and information that takes into account other section 403(b) contracts or qualified employer plans, such as whether a severance from employment has occurred for purposes of the distribution restrictions and whether the hardship withdrawal rules in the regulations are satisfied. Additional information that is required is information necessary for the resulting contract or any other contract to which contributions have been made by the employer to satisfy other tax requirements, such as whether a plan loan constitutes a deemed distribution under section 72(p).

These regulations also authorize the IRS to issue guidance of general applicability allowing exchanges in other cases. This authority is limited to cases in which the resulting contract has procedures that the IRS determines are reasonably designed to ensure compliance with those requirements of section 403(b) or other tax provisions that depend on either information concerning the participant's employment or information that takes into account other section 403(b) contracts or qualified employer plans. For example, the procedures must be reasonably designed to determine whether a severance from employment has occurred for purposes of the distribution restrictions, whether the hardship withdrawal rules are satisfied, and whether a plan loan constitutes a deemed distribution under section 72(p). By contrast, procedures that rely on an employee certification, such as whether a severance from employment has occurred or whether the participant has other outstanding loans, would generally not be adequate to meet this standard, because such a certification is not disinterested, and also because of the lack of employer oversight in the certification process to ensure accuracy.

Plan-to-Plan Transfers

The final regulations expand the rules in the 2004 proposed regulations under which plan-to-plan transfers would have been permitted only if the participant was an employee of the employer maintaining the receiving plan. Under the final regulations, plan-to-plan transfers are permitted if the participant whose assets are being transferred is an employee or former employee of the employer (or business of the employer) that maintains the receiving plan and certain additional requirements are met. However, the final regulations retain the rules that were in the 2004 proposed regulations prohibiting a plan-to-plan transfer to a qualified plan, an eligible plan under section 457(b), or any other type of plan that is not a section 403(b) plan, except as described in the next paragraph. Similarly, a section 403(b) plan is not permitted to accept a transfer from a qualified plan, an eligible plan under section 457(b), or any other type of plan that is not a section 403(b) plan.

Purchases of Permissive Service Credit and Certain Repayments

The final regulations, like the 2004 proposed regulations, include an exception permitting a section 403(b) plan to provide for the transfer of its assets to a qualified plan under section 401(a) to purchase permissive service credit under a defined benefit governmental plan or to make a re-

payment to a defined benefit governmental plan.

Limitations on Contributions

The final regulations, like the 2004 proposed regulations, provide that the section 403(b) exclusion applies only to the extent that all amounts contributed by the employer for the purchase of an annuity contract for the participant do not exceed the applicable limits under section 415. The final regulations retain the rule in the 2004 proposed regulations that if an excess annual addition is made to a contract that otherwise satisfies the requirements of section 403(b), then the portion of the contract that includes the excess will fail to be a section 403(b) contract (and instead will be a contract to which section 403(c), relating to nonqualified annuity contracts, applies) and the remaining portion of the contract that includes the contribution that is not in excess of the section 415 limitations is a section 403(b) contract. This rule under which only the excess annual addition is subject to section 403(c) does not apply unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for the portion that includes the excess and for the section 403(b) portion (which is the portion that includes the amount that is not in excess of the section 415 limitations).

With respect to section 403(b) elective deferrals, section 403(b) applies only if the contract is purchased under a plan that includes the elective deferral limits under section 402(g), including aggregation of all plans, contracts, or arrangements of the employer that are subject to the limits of section 402(g). As in the 2004 proposed regulations, the final regulations require a section 403(b) contract to include this limit on section 403(b) elective deferrals, as imposed under sections 401(a)(30) and 402(g). For purposes of the final regulations, the term "elective deferral" includes a designated Roth contribution as well as a pre-tax elective contribution. These rules are generally the same as the rules for qualified cash or deferred arrangements (CODAs) under section 401(k).

Any contribution made for a participant to a section 403(b) contract for a taxable year that exceeds either the section 415 maximum annual contribution limits or the section 402(g) elective deferral limit constitutes an excess contribution that is included in gross income for that taxable year (or, if later, the taxable year in which the contract becomes nonforfeitable). The final regulations, like the 2004 proposed regulations, provide that the section 403(b) plan (including contracts under the plan) may provide that any excess deferral as a result of a failure to comply with the section 402(g) elective deferral limit for the taxable year with respect to any section 403(b) elective deferral made for a participant by the employer will be distributed to the participant, with allocable net income, no later than April 15 or otherwise in accordance with section 402(g).

Catch-up Contributions

A section 403(b) plan may provide for additional catch-up contributions for a participant who is age 50 by the end of the year, provided that those age 50 catch-up contributions do not exceed the catch-up limit under section 414(v) for the taxable year ($5,000 for 2007). In addition, a section 403(b) plan may provide that an employee of a qualified organization who has at least 15 years of service (disregarding any period during which an individual is not an employee of the eligible employer) is entitled to a special section 403(b) catch-up limit. Under the special section 403(b) catch-up limit, the section 402(g) limit is increased by the lowest of the following three amounts: (i) $3,000; (ii) the excess of $15,000 over the amount not included in gross income for prior taxable years by reason of the special section 403(b) catch-up rules, plus elective deferrals that are designated Roth contributions;[4] or (iii) the excess of (A) $5,000 multiplied by the number of years of service of the employee with the qualified organization, over (B) the total elective deferrals made for the employee by the qualified organization for prior taxable years. For this purpose, a qualified organization is an eligible employer that is a school, hospital, health and welfare service agency (including a home health service agency), or a church-related organization.

The 2004 proposed regulations defined a health and welfare service agency as either an organization whose primary activity is to provide medical care as defined in section 213(d)(1) (such as a hospice), or a section 501(c)(3) organization whose primary activity is the prevention of cruelty to individuals or animals or which provides substantial personal services to the needy as part of its primary activity (such as a section 501(c)(3) organization that provides meals to needy individuals). In response to several commentators' requests, the final regulations expand this definition to include an adoption agency and an agency that provides either home health services or assistance to individuals with substance abuse problems or that provides help to the disabled.

Like the 2004 proposed regulations, the final regulations provide that any catch-up contribution for an employee who is eligible for both an age 50 catch-up and the special section 403(b) catch-up is treated first as a special section 403(b) catch-up to the extent a special section 403(b) catch-up is permitted, and then as an amount contributed as an age 50 catch-up (to the extent the age 50 catch-up amount exceeds the maximum special section 403(b) catch-up).

Timing of Distributions and Benefits

The final regulations, like the 2004 proposed regulations, contain provisions reflecting the statutory rules regarding when distributions can be made from a section 403(b) plan. Distributions of amounts attributable to section 403(b) elective deferrals may not be paid to a participant earlier than when the participant has a severance from employment, has a hardship, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½. Hardship is generally defined under regulations issued under section 401(k). In addition, amounts held in a custodial account attributable to employer contributions (that are not section 403(b)

[4] A technical correction was made to section 402(g)(7)(A)(ii) by section 407(a) of the Gulf Opportunity Zone Act of 2005 (119 Stat. 2577), P.L. 109–135, to clarify that the aggregate $15,000 limit on such contributions was reduced not only by pre-tax elective deferrals made pursuant to the special section 403(b) catch-up rules, but also by designated Roth contributions. Treasury has recommended that this language be further changed to reflect the intent that the reduction for designated Roth contributions at section 402(g)(7)(A)(ii)(II) be limited to designated Roth contributions that have been made pursuant to the special section 403(b) catch-up rules.

elective deferrals) may not be paid to a participant before the participant has a severance from employment, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½. This rule also applies to amounts transferred out of a custodial account to an annuity contract or retirement income account, including earnings thereon.

The final regulations, as did the 2004 proposed regulations, include a number of exceptions to the timing restrictions. For example, the rule for elective deferrals does not apply to distributions of section 403(b) elective deferrals (not including earnings thereon) that were contributed before January 1, 1989.

The final regulations, as did the 2004 proposed regulations, reflect the direct rollover rules of section 401(a)(31) and the related requirements of section 402(f) concerning the written explanation requirement for distributions that qualify as eligible rollover distributions, including conforming the timing rule to the rule for qualified plans.

In addition to the restrictions described in this preamble, the final regulations generally retain, with certain modifications, the additional rules from the 2004 proposed regulations relating to when distributions are permitted to be made from a section 403(b) plan, including the restrictions described in this preamble imposed by sections 403(b)(7)(A)(ii) and (11) on distribution of amounts held in custodial accounts and elective deferrals, and the tax treatment of distributions from section 403(b) plans. Comments raised no objections to the various rules that were proposed in 2004, other than concerning the general rule requiring the occurrence of a stated event. The 2004 proposed regulations generally would have required the occurrence of a stated event in order to commence distributions of amounts attributable to employer contributions to section 403(b) plans other than elective deferrals or distributions from custodial accounts. The stated event rule is substantially the same as the rule applicable to qualified defined contribution plans that are not money purchase pension plans (under §1.401–1(b)(1)(ii)), so that a plan is permitted to provide for a distribution upon completion of a fixed number of years (such as five years of participation), the attainment of a stated age, or upon the occurrence of some other identified event (such as the occurrence of a financial need,[5] including a need to buy a home).

However, the final regulations make a number of changes relating to distributions. First, the final regulations clarify that after-tax employee contributions are not subject to any in-service distribution restrictions. Second, the regulations address comments that were made regarding certain disability arrangements by clarifying that, if an insurance contract includes provisions under which contributions will be continued in the event a participant becomes disabled, then that benefit is treated as an incidental benefit that must satisfy the incidental benefit requirement applicable to qualified plans (at §1.401–1(b)(1)(ii)). Third, changes were made to reflect elective deferrals that are designated Roth contributions, discussed further later in this preamble under the heading, "Requirement of Certain Separate Accounts Under Section 403(b)." Fourth, §1.403(b)–7(b)(5) has been added referencing the automatic rollover rules of section 401(a)(31), in accordance with section 403(b)(10). See Notice 2005–5, 2005–1 C.B. 337, for rules interpreting this requirement. Fifth, a cross-reference to certain employment tax rules was added, discussed under the heading "Employment Taxes." Sixth, in response to comments, the final regulations provide that the general rule requiring the occurrence of a stated event in order for distributions to commence does not apply to insurance contracts issued before January 1, 2009, and a special rule has been added allowing conforming amendments to be adopted by plans that are subject to ERISA. Section 1.403(b)–10(c) has been clarified to indicate that in order to be treated as a distribution under this section, the distribution must be pursuant to a QDRO as described in section 206(d)(3) of ERISA and the Department of Labor's guidance.

Severance From Employment

The final regulations, like the 2004 proposed regulations, define severance from employment in a manner that is generally the same as the regulations under section 401(k) (see §1.401(k)–1(d)(2)), but provide that, for purposes of distributions from a section 403(b) plan, a severance from employment occurs on any date on which the employee ceases to be employed by an eligible employer that maintains the section 403(b) plan. Thus, a severance from employment would occur when an employee ceases to be employed by an eligible employer, even though the employee may continue to be employed by an entity that is part of the same controlled group but that is not an eligible employer, or on any date on which the employee works in a capacity that is not employment with an eligible employer. Examples of the situations that constitute a severance from employment include: an employee transferring from a section 501(c)(3) organization to a for-profit subsidiary of the section 501(c)(3) organization; an employee ceasing to work for a public school, but continuing to be employed by the same State; and an individual employed as a minister for an entity that is neither a State nor a section 501(c)(3) organization ceasing to perform services as a minister, but continuing to be employed by the same entity.

Section 401(a)(9)

The final regulations, like the 2004 proposed regulations, require section 403(b) plans to comply with rules similar to those in the existing regulations relating to the required minimum distribution requirements of section 401(a)(9), but with some minor changes (for example, omitting the special rules for 5-percent owners). Thus, section 403(b) contracts must satisfy the incidental benefit rules. Guidance concerning the application of the incidental benefit requirements to permissible nonretirement benefits such as life, accident, or health benefits is contained in revenue rulings.[6]

[5] See, for example, Rev. Rul. 56–693, 1956–2 C.B. 282.

[6] See, for example, Rev. Rul. 61–121, 1961–2 C.B. 65; Rev. Rul. 68–304, 1968–1 C.B. 179; Rev. Rul. 72–240, 1972–1 C.B. 108; Rev. Rul. 72–241, 1972–1 C.B. 108; Rev. Rul. 73–239, 1973–1 C.B. 201; and Rev. Rul. 74–115, 1974–1 C.B. 100.

Loans

The final regulations adopt the provisions in the 2004 proposed regulations relating to loans to participants from a section 403(b) contract.

QDROs

The final regulations also adopt the 2004 proposed regulations' limited rules relating to QDROs under section 414(p). Section 414(p)(9) provides that the QDRO rules only apply to plans that are subject to the anti-alienation provisions of section 401(a)(13), except that section 414(p)(9) also provides that the section 414(p) QDRO rules apply to a section 403(b) contract. The final regulations, like the proposed regulations, clarify that the QDRO rules under section 414(p) apply to section 403(b) plans. The Secretary of Labor has authority to interpret the QDRO provisions, section 206(d)(3), and its parallel provision at section 414(p) of the Code, and to issue QDRO regulations in consultation with the Secretary of the Treasury. 29 U.S.C. 1056(d)(3)(N). Under section 401(n) of the Internal Revenue Code, the Secretary of the Treasury has authority to issue rules and regulations necessary to coordinate the requirements of section 414(p) (and the regulations issued by the Secretary of Labor thereunder) with the other provisions of Chapter I of Subtitle A of the Code.

Taxation of Distributions and Benefits From a Section 403(b) Contract

The final regulations, like the 2004 proposed regulations, reflect the statutory provisions regarding the taxation of distributions and benefits from section 403(b) contracts, including the provision that generally only amounts actually distributed from a section 403(b) contract are includible in the gross income of the recipient under section 72 for the year in which distributed. The final regulations also reflect the rule that any payment that constitutes an eligible rollover distribution is not taxed in the year distributed to the extent the payment is rolled over to an eligible retirement plan. The payor must withhold 20 percent Federal income tax, however, if an eligible rollover distribution is not rolled over in a direct rollover. Another provision requires the payor to give proper written notice to the section 403(b) participant or beneficiary concerning the eligible rollover distribution provision.

Section 403(b) Nondiscrimination and Universal Availability Rules

Nondiscrimination

Section 403(b)(12)(A)(i) requires that employer contributions, other than elective deferrals, and after-tax employee contributions made under a section 403(b) contract satisfy a specified series of requirements (the nondiscrimination requirements) in the same manner as a qualified plan under section 401(a). These nondiscrimination requirements include rules relating to nondiscrimination in contributions, benefits, and coverage (sections 401(a)(4) and 410(b)), a limitation on the amount of compensation that can be taken into account (section 401(a)(17)), and the average contribution percentage rules of section 401(m) (relating to matching and after-tax employee contributions).

Notice 89–23 discusses these requirements and provides a good faith reasonable standard for satisfying these requirements. The 2004 proposed regulations would have eliminated the good faith reasonable standard for satisfying the nondiscrimination requirements of section 403(b)(12)(A)(i) for non-governmental plans. Comments acknowledged the need for and the IRS's authority to make this change. Accordingly, these final regulations do not include the Notice 89–23 good faith reasonable standard.

However, as discussed in this preamble under the heading "Treatment of Controlled Groups that Include Certain Entities," the Notice 89–23 good faith reasonable standard will continue to apply to State and local public schools (and certain church entities) for determining the controlled group. Although the general nondiscrimination requirements do not apply to governmental plans (within the meaning of section 414(d)), these plans are required to limit the amount of compensation to the amount permitted under section 401(a)(17) for all purposes under the plan, including, for example the amount of compensation taken into account for employer contributions, and are required to satisfy the universal availability rule (described in this preamble under the heading "Universal Availability for Elective Deferrals"). A non-governmental section 403(b) plan that provides for nonelective employer contributions must satisfy the coverage requirements of section 410(b) and the nondiscrimination requirements of section 401(a)(4) with respect to such contributions.

These final regulations, like the 2004 proposed regulations, require a section 403(b) plan to comply with the nondiscrimination requirements for matching contributions in the same manner as a qualified plan. Thus, a non-governmental section 403(b) plan that provides for matching contribution must satisfy the nondiscrimination requirements of section 401(m). The nondiscrimination requirements are generally tested using compensation as defined in section 414(s) and are applied on an aggregated basis taking into account all plans of the employer. See the discussion under the heading "Treatment of Controlled Groups that Include Certain Entities."

The nondiscrimination requirements do not apply to section 403(b) elective deferrals. Instead, a universal availability requirement, discussed further in the next section, applies to all section 403(b) elective deferrals (including elective deferrals made under a governmental section 403(b) plan).

Universal Availability for Elective Deferrals

The universal availability requirement of section 403(b)(12)(A)(ii) provides that all employees of the eligible employer must be permitted to elect to have section 403(b) elective deferrals contributed on their behalf if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals. Under the 2004 proposed regulations, the universal availability requirement would not have been satisfied unless the contributions were made pursuant to a section 403(b) plan and the plan permitted all employees of an employer an opportunity to make elective deferrals if any employee of that employer has the right to make elective deferrals.

The rules in the final regulations relating to the universal availability requirement are substantially similar to those in

the 2004 proposed regulations. The final regulations clarify that the employee's right to make elective deferrals also includes the right to designate section 403(b) elective deferrals as designated Roth contributions (if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals as designated Roth contributions).

The preamble to the 2004 proposed regulations requested comments regarding certain exclusions that have been permitted under transitional guidance issued in 1989. Specifically, Notice 89–23 had allowed, pending issuance of regulatory guidance, the exclusion of the following classes of employees for purposes of the universal availability rule: employees who are covered by a collective bargaining agreement; employees who make a one-time election to participate in a governmental plan described in section 414(d), instead of a section 403(b) plan; professors who are providing services on a temporary basis to another public school for up to one year and for whom section 403(b) contributions are being made at a rate no greater than the rate each such professor would receive under the section 403(b) plan of the original public school; and employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement.

The comments submitted in response to the request generally requested to have these exclusions continue to be allowed. However, after consideration of the comments received, the IRS and Treasury Department have concluded that these exclusions are inconsistent with the statute and, accordingly, they are not permitted under these regulations. Nonetheless, as described further in the following paragraphs, other rules may provide relief with respect to individuals who are under a vow of poverty and to certain university professors affected.

Rev. Rul. 68–123, 1968–1 C.B. 35, as clarified by Rev. Rul. 83–127, 1983–2 C.B. 25, generally excludes from gross income, and from wage withholding, income of an individual working under a vow of poverty for an employer controlled by a church and the individual is treated as working as an agent of the church, not as an employee. While these regulations do not provide an exclusion from the universal availability requirement for individuals working under a vow of poverty, individuals who work for an institution that is controlled by the church organization and whose compensation from the employer is not treated as wages for purposes of income tax withholding under Rev. Rul. 68–123 may be excluded from the section 403(b) plan without violating the universal availability requirement because they are not treated as employees of the entity maintaining the section 403(b) plan.

With respect to an exclusion relating to visiting professors, if an individual is rendering services to a university as a visiting professor, but continues to receive his or her compensation from his or her home university and elective deferrals on his or her behalf are made under the home university's section 403(b) plan, the final regulations do not, for purposes of section 403(b) and in any case in which such treatment is appropriate, preclude the plan maintained by the home university from treating the visiting professor as an eligible employee of the home university.

The discussion in this preamble under the heading "Applicability date" describes transition relief for any existing plan that excludes, in accordance with Notice 89–23, collective bargaining employees, visiting professors, government employees who make a one-time election, or employees who work under a vow of poverty.

Rules Relating to Funding Arrangements

These regulations retain, with certain modifications, the rules in the 2004 proposed regulations relating to the permitted investments for a section 403(b) contract. In general, a section 403(b) plan must be funded either by an annuity contract issued by an insurance company qualified to issue annuities in a State or a custodial account held by a bank (or a person who satisfies the conditions in section 401(f)(2)) where all of the amounts in the account are held for the exclusive benefit of plan participants or their beneficiaries in regulated investment companies (mutual funds) and certain other conditions are satisfied (including restrictions on distributions). Additional rules apply with respect to retirement income accounts for plans of a church or a convention or association of churches as discussed in the next section.

Special Rules for Church Plans' Retirement Income Accounts

The final regulations, like the 2004 proposed regulations, include a number of special rules for church plans. Under section 403(b)(9), a retirement income account for employees of a church-related organization is treated as an annuity contract for purposes of section 403(b). Under these regulations, the rules for a retirement income account are based largely on the provisions of section 403(b)(9) and the legislative history of TEFRA. The regulations define a retirement income account as a defined contribution program established or maintained by a church-related organization under which (i) there is separate accounting for the retirement income account's interest in the underlying assets (namely, it must be possible at all times to determine the retirement income account's interest in the underlying assets and to distinguish that interest from any interest that is not part of the retirement income account), (ii) investment performance is based on gains and losses on those assets, and (iii) the assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. For this purpose, assets are treated as diverted to the employer if the employer borrows assets from the account. A retirement income account must be maintained pursuant to a program which is a plan and the plan document must state (or otherwise evidence in a similarly clear manner) the intent to constitute a retirement income account.

If any asset of a retirement income account is owned or used by a participant or beneficiary, then that ownership or use is treated as a distribution to that participant or beneficiary. The regulations also provide that a retirement income account that is treated as an annuity contract is not a custodial account (even if it is invested in stock of a regulated investment company).

A life annuity can generally only be provided from an individual account by the purchase of an insurance annuity contract. However, in light of the special rules applicable to church retirement income accounts, the final regulations, like the 2004

proposed regulations, permit a life annuity to be paid from such an account if certain conditions are satisfied. The conditions are that the distribution from the account has an actuarial present value, at the annuity starting date, that is equal to the participant's or beneficiary's accumulated benefit, based on reasonable actuarial assumptions, including assumptions regarding interest and mortality, and that the plan sponsor guarantee benefits in the event that a payment is due that exceeds the participant's or beneficiary's accumulated benefit.

Termination of a Section 403(b) Plan

The final regulations adopt the provisions of the 2004 proposed regulations permitting an employer to amend its section 403(b) plan to eliminate future contributions for existing participants, and allowing plan provisions that permit plan termination and a resulting distribution of accumulated benefits, with the associated right to roll over eligible rollover distributions to an eligible retirement plan, such as an individual retirement account or annuity (IRA). Comments on the rules in the 2004 proposed regulations regarding plan termination were favorable. In general, the distribution of accumulated benefits is permitted under these regulations only if the employer (taking into account all entities that are treated as a single employer under section 414 on the date of the termination) does not make contributions to any section 403(b) contract that is not part of the plan during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. However, if at all times during the period beginning 12 months before the termination and ending 12 months after distribution of all assets from the terminated plan, fewer than 2 percent of the employees who were eligible under the section 403(b) plan as of the date of plan termination are eligible under the alternative section 403(b) contract, the other section 403(b) contract is disregarded. In order for a section 403(b) plan to be considered terminated, all accumulated benefits under the plan must be distributed to all participants and beneficiaries as soon as administratively practicable after termination of the plan. A distribution for this purpose includes delivery of a fully paid individual insurance annuity contract.

Effect of a Failure to Satisfy Section 403(b)

These regulations include revisions to the 2004 proposed regulations that address the effects of a failure to satisfy section 403(b). Section 403(b)(5) provides for all of the contracts purchased for an employee by an employer to be treated as a single contract for purposes of section 403(b). Thus, if a contract fails to satisfy any of the section 403(b) requirements, then not only that contract but also any other contract purchased for that individual by that employer would fail to be a contract that qualifies for tax-deferral under section 403(b).

Under these regulations, as under the 2004 proposed regulations, if a contract includes any amount that fails to satisfy the requirements of these regulations, then, except for special rules relating to vesting conditions and excess contributions (under section 415 or section 402(g)), that contract and any other contract purchased for that individual by that employer does not constitute a section 403(b) contract. In addition, if a contract is not established pursuant to a written plan, then the contract does not satisfy section 403(b). Thus, if an employer fails to have a written plan, any contract purchased by that employer would not be a section 403(b) contract. Similarly, if an employer is not an eligible employer for purposes of section 403(b), none of the contracts purchased by that employer is a section 403(b) contract. If a plan fails to satisfy the nondiscrimination rules (including a failure to operate the plan in accordance with its coverage provisions or a failure to operate the plan in a manner that satisfies the nondiscrimination rules), none of the contracts issued under the plan would be section 403(b) contracts.

However, under these regulations, any operational failure, other than those described in the preceding paragraph, that is solely within a specific contract generally will not adversely affect the contracts issued to other employees that qualify in form and operation with section 403(b). Thus, for example, if an employee's elective deferrals under a contract, when aggregated with any other contract, plan, or arrangement of the employer for that employee during a calendar year, exceed the maximum deferral amount permitted under section 402(g)(1)(A) (as made applicable by section 403(b)(1)(E)), the failure would adversely affect the contracts issued to the employee by that employer, but would not adversely affect any other employee's contracts.

Requirement of Certain Separate Accounts Under Section 403(b)

The final regulations, like the 2004 proposed regulations, include technical provisions addressing certain situations in which a separate account[7] is necessary under section 403(b). For example, a separate bookkeeping account is required for any contract in which only a portion of the employee's interest is vested because, in such a case, separate accounting for each type of contribution (and earnings thereon) that is subject to a different vesting schedule is necessary to determine which vested contributions, including earnings thereon, are treated as held under a section 403(b) contract. In addition, the final regulations also clarify that if the section 403(b) plan fails to establish a separate account for contributions in excess of the section 415(c) limitation under section 403(c) (relating to nonqualified annuity contracts whose present values are generally subject to current taxation), so that such excess contributions are commingled in a single insurance contract with contributions intended to qualify under section 403(b) without maintaining a separate account for each amount, then none of the amounts held under the insurance contract qualify for tax deferral under section 403(b). Any such separate account must be established by the time the excess contribution is made to the plan. The separate account for excess contributions under section 415(c) is necessary to effectuate differences in the tax treatment of distributions (for example, because of the need to properly allocate basis under section 72 and separately identify amounts that can be rolled over). Similarly, a separate account is required for elective deferrals to be treated

[7] These rules are not related to segregated asset accounts under section 817(h).

as held in a designated Roth account, as described in the following paragraph.

Designated Roth Accounts

These regulations also include final regulations relating to elective deferrals that are designated Roth contributions under a section 403(b) plan. These regulations, however, do not address the taxation of a distribution of designated Roth contributions from a section 403(b) plan. See §1.402A–1 for those rules. The final regulations relating to elective deferrals under a section 403(b) plan that are designated Roth contributions are substantially unchanged from the proposed regulations that were issued in January of 2006 regarding designated Roth accounts under a section 403(b) plan.[8]

Interaction Between Title I of ERISA and Section 403(b) of the Code

The Treasury Department and the IRS consulted with the Department of Labor in connection with both the 2004 proposed regulations and these final regulations concerning the interaction between Title I of ERISA and section 403(b) of the Internal Revenue Code. In particular, the consultation focused on whether the requirements imposed on employers in these regulations would exceed the scope of the Department of Labor's safe harbor regulation at 29 CFR §2510.3–2(f) and result in all section 403(b) programs sponsored by tax-exempt employers (other than governmental plans and certain church plans) falling under the purview of ERISA.

According to the Department of Labor, Title I of ERISA generally applies to "any plan, fund, or program . . . established or maintained by an employer or by an employee organization, or by both, to the extent that . . . such plan, fund, or program . . . provides retirement income to employees, or . . . results in a deferral of income by employees for periods extending to the termination of covered employment or beyond." ERISA section 3(2)(A). However, governmental plans and church plans are generally excluded from coverage under Title I of ERISA. ERISA section 4(b)(1) and (2). Therefore, contracts purchased or provided under a program that is either a "governmental plan" under section 3(32) of ERISA or a "church plan" under section 3(33) of ERISA are not generally covered under Title I. However, section 403(b) of the Internal Revenue Code is also available with respect to contracts purchased or provided by employers for employees of a section 501(c)(3) organization, and many programs for the purchase of section 403(b) contracts offered by such employers are covered under Title I of ERISA as part of an "employee pension benefit plan" within the meaning of section 3(2)(A) of ERISA. The Department of Labor promulgated a regulation in 1975, 29 CFR §2510.3–2(f), describing circumstances under which an employer's program for the purchase of section 403(b) contracts for its employees, which is not otherwise excluded from coverage under Title I, will not be considered to constitute the establishment or maintenance of an "employee pension benefit plan" under Title I of ERISA.

As described in the preamble to the 2004 proposed regulations, the Department of Labor advised the Treasury Department and the IRS that the proposed regulations did not appear to require, but left open the possibility that an employer may undertake, responsibilities in connection with a section 403(b) program that would exceed the limits in the safe harbor and constitute establishing and maintaining an ERISA-covered plan. Comments submitted on the proposal supported the continued availability of non-Title I section 403(b) programs to employees of tax-exempt employers and asked for additional guidance for employers who offer their employees access to such programs.

According to the Department of Labor, review of the final section 403(b) regulations has not led the Department of Labor to change its view on the principles that apply in determining whether any given section 403(b) program is covered by Title I of ERISA. Even though the differences between the tax rules for section 403(b) programs and those governing other ERISA-covered pension plans may have diminished as a result of the final section 403(b) regulations, the Department of Labor continues to be of the view that tax-exempt employers can comply with the requirements in the section 403(b) regulations and remain within the Department of Labor's safe harbor for tax-sheltered annuity programs funded solely by salary deferrals. The Department of Labor notes, however, that the new section 403(b) regulations offer employers considerable flexibility in shaping the extent and nature of their involvement. The question of whether any particular employer, in complying with the section 403(b) regulations, has established or maintained a plan covered under Title I of ERISA must be analyzed on a case-by-case basis applying the criteria set forth in 29 CFR §2510.3–2(f) and section 3(2) of ERISA. To assist employers interested in offering their employees access to a tax sheltered annuity program that would not be an ERISA-covered plan, the Department of Labor is issuing, in conjunction with the final publication of this regulation, a Field Assistance Bulletin to provide additional guidance on the interaction of the safe harbor and the requirements in these final regulations. The Field Assistance Bulletin can be found at *www.dol.gov/ebsa.*

Treatment of Controlled Groups that Include Tax-Exempt Entities

The final regulations retain the basic rules in the 2004 proposed regulations regarding controlled groups for entities that are tax-exempt under section 501(a), but with a number of modifications to reflect the comments that were made. As in the 2004 proposed regulations, these rules are not limited to section 403(b) plans, but apply more broadly for purposes of determining when tax-exempt entities are treated as a single employer under sections 414(b), (c), (m), and (o). Thus, for example, these rules apply for purposes of plans maintained by a tax-exempt entity that are intended to be qualified under section 401(a). These rules can apply to treat two section 501(c) organizations as a single employer, or a section 501(c) organization and a non-section 501(c) organization as a single employer, if the organizations are under common control. For a section 501(c)(3) organization that makes contributions to a section 403(b) plan, these rules would be generally relevant for purposes of the nondiscrimination requirements, as well as for the section 415 contribution limitations, the special

[8] REG–146459–05, 2006–1 C.B. 504, published in the **Federal Register** (71 FR 4320) on January 26, 2006.

section 403(b) catch-up contributions, and the section 401(a)(9) minimum distribution rules.

Under the rules in the 2004 proposed regulations, the employer for a plan maintained by a section 501(c) organization would include not only the organization whose employees participate in the plan, but also any other organization that is under common control with the tax-exempt organization. Under the 2004 proposed regulations, the existence of control would be determined based on the facts and circumstances. For this purpose, common control would exist between a tax-exempt organization and another organization if at least 80 percent of the directors or trustees of one organization were either representatives of, or directly or indirectly controlled by, the other organization.[9] The 2004 proposed regulations permitted tax-exempt organizations to choose to be aggregated (permissive aggregation) if they maintained a single plan covering one or more employees from each organization and the organizations regularly coordinated their day-to-day exempt activities. These rules were subject to an overall anti-abuse rule. The final regulations retain the basic rules in the 2004 proposed regulations and the anti-abuse rule, and add an example to illustrate when the anti-abuse rule might apply.

Comments on the 2004 proposed regulations generally approved of the proposed controlled group rules, but some comments argued for expanding the category of entities that can use the permissive aggregation rules. These comments typically did not recommend an overall standard for when permissive aggregation should be permitted, but identified certain specific practices which would be facilitated by permissive aggregation. In response, these regulations authorize the IRS to issue published guidance permitting other types of combinations of entities that include tax-exempt entities to elect to be treated as under common control for one or more specified purposes. This authority is limited to situations in which there are substantial business reasons for maintaining each entity in a separate trust, corporation, or other form, and under which common control treatment would be consistent with the anti-abuse standards in the regulations. It is expected that this authority would not be exercised unless the IRS determines that the organizations are so integrated in their operations as to effectively constitute a single coordinated employer for purposes of sections 414(b), (c), (m), and (o), including common employee benefit plans.

A comment was also received stating that a legally required trusteeship for a labor union that has been imposed in order to correct corruption or financial malpractice[10] should not constitute control. In response, a change was made to the regulations to reflect the intent that whether a person has the power to appoint and replace a trustee or director is based on facts and circumstances. For example, that power would generally not exist if that power was extremely limited due to the application of other laws, such as where a labor union was put under trusteeship pursuant to a court order, the trusteeship is for the sole purpose of correcting corruption, financial malpractice, or similar circumstances, and the replacement trustees were permitted to serve only for the time necessary for that purpose.

These controlled group rules for tax-exempt entities generally do not apply to certain church entities under section 3121(w)(3). These rules also do not apply to a State or local government or a federal government entity. Until further guidance is issued, church entities under section 3121(w)(3)(A) and (B) and State or local government public schools that sponsor section 403(b) plans can continue to rely on the rules in Notice 89–23 for determining the controlled group.

Employment Taxes

These regulations include several new cross-references to certain rules concerning the application of employment taxes. For example, the definition of an elective deferral at §1.403(b)–2(a)(7) of these regulations refers to §1.402(g)(3)–1 of these regulations, which in turn refers to section 3121(a)(5)(D). See §31.3121(a)(5)–2T of the temporary regulations for additional guidance on section 3121(a)(5)(D) (defining salary reduction agreement for purposes of the Federal Insurance Contributions Act (FICA)).

As another example, §1.403(b)–7(f) of these regulations generally references the special income tax withholding rules under section 3405 for purposes of income tax withholding on distributions from section 403(b) contracts and also references the special rules at §1.72(p)–l, Q&A–15, and §35.3405(c)–1, Q&A–11, relating to income tax withholding for loans deemed distributed from qualified employer plans, including section 403(b) contracts. However, the general income tax withholding rules apply for purposes of income tax withholding for annuity contracts or custodial accounts that are not section 403(b) contracts, as well as for cases in which an annuity contract or custodial account ceases to qualify as a section 403(b) contract. See section 3401 and §§1.83–8(a) and 35.3405–1T, Q&A–18.

Effect of These Regulations on Other Guidance

Since the existing regulations were issued in 1964, a number of revenue rulings and other items of guidance under section 403(b) have become outdated as a result of changes in law. In addition, as a result of the inclusion in these regulations of much of the guidance that the IRS has issued regarding section 403(b), these regulations effectively supersede or substantially modify a number of revenue rulings and notices that have been issued under section 403(b). Thus, as indicated in the preamble to the 2004 proposed regulations, the IRS anticipates taking action in the future to obsolete many revenue rul-

[9] Treas. Reg. §1.512(b)–1(l)(4)(i)(*b*) uses a similar test to determine control of a non-stock organization. Note that those regulations do not reflect amendments that were made in section 512(b)(13) by section 1041(a) of the Taxpayer Relief Act of 1997 (111 Stat. 788).

[10] See 29 U.S.C. 462.

ings, notices, and other guidance under section 403(b).[11]

However, the positions taken in certain rulings and other outstanding guidance are expected to be retained. For example, it is intended that the existing rules[12] for determining when employees are performing services for a public school will continue to apply. Further, as discussed above in the preamble under the heading, "Treatment of Controlled Groups that Include Tax-Exempt Entities," church entities under section 3121(w)(3)(A) and (B) and public schools that sponsor section 403(b) plans can continue to rely on the rules in Notice 89–23 for determining the controlled group. In addition, certain positions taken in prior guidance are expected to be reevaluated in light of these regulations, such as Rev. Rul. 2004–67, 2004–2 C.B. 28, which revised the group trust rules of Rev. Rul. 81–100, 1981–1 C.B. 326. With the issuance of these regulations, a number of conforming changes will be considered for the compliance programs maintained by the IRS, as most recently published in Rev. Proc. 2006–27, 2006–1 C.B. 945 (EPCRS), including, for example, to reflect the written plan requirement and the positions described above in this preamble under the heading, "Effect of a Failure to Satisfy Section 403(b)."

The prior regulations under section 403(b) had included certain rules for determining the amount of the contributions made for an employee under a defined benefit plan, based on the employee's pension under the plan. These rules are generally no longer applicable for section 403(b) because the limitations on contributions to a section 403(b) contract under section 415(c) are no longer coordinated with accruals under a defined benefit plan.[13] However, the rules for determining the amount of contributions made for an employee under a defined benefit plan in the prior regulations under section 403(b) had also been used for purposes of section 402(b) (relating to nonqualified plans funded through trusts). These regulations replace those rules with regulations under section 402(b) that provide for the same rules (those in the section 403(b) regulations that were in effect prior to these regulations) to continue to apply for purposes of section 402(b). However, these section 402(b) regulations also authorize the Commissioner to issue guidance for determining the amount of the contributions made for an employee under a defined benefit plan under section 402(b).

Applicability Date

These regulations are generally applicable for taxable years beginning after December 31, 2008. Thus, because individuals will almost uniformly be on a calendar taxable year, these regulations will generally apply on January 1, 2009. However, these regulations include a number of explicit transition rules.

For a section 403(b) plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on July 26, 2007, the regulations do not apply until the earlier of: (1) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after July 26, 2007; or (2) July 26, 2010. For a section 403(b) plan maintained by a church-related organization for which the authority to amend the plan is held by a church convention (within the meaning of section 414(e)), the regulations do not apply before the beginning of the first plan year following December 31, 2009.

There are also special applicability dates for several of the specific provisions in these regulations. First, special rules apply to plans which may have included one or more of the exclusions that Notice 89–23 permitted for the universal availability rule, but which are no longer permitted under these regulations. Specifically, a special rule applies if a plan has eligibility conditions for elective deferrals relating to employees who make a one-time election to participate in a governmental plan described in section 414(d) instead of a section 403(b) plan, professors who are providing services on a temporary basis to another school for up to one year and for whom section 403(b) contributions are being made at a rate no greater than the rate each such professor would receive under the section 403(b) plan of the original school, or employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement. If, as permitted by Notice 89–23, a plan excludes any of these three classes of employees from eligibility to make elective deferrals on July 26, 2007, the plan is permitted to continue that exclusion until taxable years beginning on or after January 1, 2010. In addition, if a plan excludes employees covered by a collective bargaining agreement from eligibility to make elective deferrals on July 26, 2007, the plan is permitted to continue that exclusion until the later of (i) the first day of the first taxable year that begins after December 31, 2008, or (ii) the earlier of (I) the date that such agreement terminates (determined without regard to any extension thereof after July 26, 2007) or (II) July 26, 2010. In the case of a governmental plan (as defined in section 414(d)) for which the authority to amend the plan is held by a legislative body that meets in legislative session, the plan is permitted to continue the exclusion until the earlier of: (i) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2009; or (ii) January 1, 2011.

These regulations (at §1.403(b)–6(b)) also provide that a section 403(b) contract is permitted to distribute retirement benefits to the participant no earlier than

[11] When these regulations go into effect, the following guidance will be outdated or superseded by these regulations and it is expected that guidance will be issued in the future to formally supersede these items: Rev. Rul. 64–333, 1964–2 C.B. 114; Rev. Rul. 65–200, 1965–2 C.B. 141; Rev. Rul. 66–254, 1966–2 C.B. 125; Rev. Rul. 66–312, 1966–2 C.B. 127; Rev. Rul. 67–78, 1967–1 C.B. 94; Rev. Rul. 67–69, 1967–1 C.B. 93; Rev. Rul. 67–361, 1967–2 C.B. 153; Rev. Rul. 67–387, 1967–2 C.B. 153; Rev. Rul. 67–388, 1967–2 C.B. 153; Rev. Rul. 68–179, 1968–1 C.B. 179; Rev. Rul. 68–482, 1968–2 C.B. 186; Rev. Rul. 68–487, 1968–2 C.B. 187; Rev. Rul. 68–488, 1968–2 C.B. 188; Rev. Rul. 69–629, 1969–2 C.B. 101; Rev. Rul. 70–243, 1970–1 C.B. 107; Rev. Rul. 87–114, 1987–2 C.B. 116; Rev. Rul. 90–24, 1990–1 C.B. 97; Notice 90–73, 1990–2 C.B. 353; Notice 92–36, 1992–2 C.B. 364; and Announcement 95–48, 1995–23 I.R.B. 13. In addition, Notice 89–23, 1989–1 C.B. 654, is likewise superseded as a result of these regulations, except to the extent described above under the heading "Treatment of Controlled Groups that Include Tax-Exempt Entities." It is expected that the following guidance will not be superseded when these regulations are issued in final form: Rev. Rul. 66–254, 1966–2 C.B. 125; Rev. Rul. 68–33, 1968–1 C.B. 175; Rev. Rul 68-58, 1968–1 C.B. 176; Rev. Rul. 68–116, 1968–1 C.B. 177; Rev. Rul. 68–648, 1968–2 C.B. 49; Rev. Rul. 68–488, 1968–2 C.B. 188; and Rev. Rul. 69–146, 1969–1 C.B. 132.

[12] Rev. Rul. 73–607, 1973–2 C.B. 145, and Rev. Rul. 80–139, 1980–1 C.B. 88.

[13] However, see §1.403(b)–10(f)(2) of these regulations for a special rule applicable to certain church defined benefit plans that were in effect on September 3, 1982.

the earliest of the participant's severance from employment or upon the prior occurrence of some event, subject to a number of exceptions (relating to distributions from custodial accounts, distributions attributable to section 403(b) elective deferrals, correction of excess deferrals, distributions at plan termination, and payment of after-tax employee contributions). This rule does not apply for contracts issued before January 1, 2009. In addition, in order to permit plans to comply with the rules relating to in-service distributions for contracts issued before January 1, 2009, the regulations provide that an amendment adopted before January 1, 2009, to comply with these rules does not violate the anti-cutback rules of section 204(g) of ERISA.

These regulations (at §1.403(b)–8(c)(2)) also do not permit a life insurance contract, an endowment contract, a health or accident insurance contract, or a property, casualty, or liability insurance contract to constitute an annuity contract for purposes of section 403(b). This rule does not apply for contracts issued before September 24, 2007.

These regulations also include specific rules relating to contract exchanges that were permitted under Rev. Rul. 90–24. These new rules do not apply to contracts received in an exchange that occurred on or before September 24, 2007, assuming that the exchange (including the contract received in the exchange) satisfies applicable pre-existing legal requirements (including Rev. Rul. 90–24).

Finally, these regulations include special applicability date rules to coordinate with recently issued regulations under sections 402A and 415.

For periods following July 26, 2007, and before the applicable date, taxpayers can rely on these regulations, except that (1) such reliance must be on a consistent and reasonable basis and (2) the special rule at §1.403(b)–10(a) of these regulations permitting accumulated benefits to be distributed on plan termination can be relied upon only if all of the contracts issued under the plan at that time satisfy all of the applicable requirements of these regulations (other than the requirement at §1.403(b)–3(b)(3)(i) of these regulations that there be a written plan).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the determination that respondents will need to spend minimal time (an average of 4.1 hours per year) complying with the contract exchange requirements in these regulations, and small entities are generally expected to spend much less time. Thus, the cost of complying with this statutory requirement is small, even for small entities. Therefore, a Regulatory Flexibility Analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal authors of these regulations are R. Lisa Mojiri-Azad and John Tolleris, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31, 54 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.403(b)–3 and adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.403(b)–6 also issued under 26 U.S.C. 403(b)(10). * * *

§1.414(c)–5 also issued under 26 U.S.C. 414(b), (c), and (o). * * *

Par. 2. Section 1.402(b)–1 is amended by revising paragraphs (a)(2) and (b)(2)(ii) to read as follows:

§1.402(b)–1 Treatment of beneficiary of a trust not exempt under section 501(a).

(a) * * *

(2) *Determination of amount of employer contributions.* If, for an employee, the actual amount of employer contributions referred to in paragraph (a)(1) of this section for any taxable year of the employee is not determinable or for any other reason is not known, then, except as set forth in rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), such amount shall be either—

(i) The excess of—

(A) The amount determined as of the end of such taxable year in accordance with the formula described in §1.403(b)–1(d)(4), as it appeared in the April 1, 2006, edition of 26 CFR Part 1; over

(B) The amount determined as of the end of the prior taxable year in accordance with the formula described in paragraph (a)(2)(i)(A) of this section; or

(ii) The amount determined under any other method utilizing recognized actuarial principles that are consistent with the provisions of the plan under which such contributions are made and the method adopted by the employer for funding the benefits under the plan.

(b) * * *

(2) * * *

(ii) If a separate account in a trust for the benefit of two or more employees is not maintained for each employee, the value of the employee's interest in such trust is determined in accordance with rules prescribed by the Commissioner under the authority in paragraph (a)(2) of this section.

* * * * *

Par. 3. Section 1.402(g)(3)–1 is added to read as follows:

§1.402(g)(3)–1 Employer contributions to purchase a section 403(b) contract under a salary reduction agreement.

(a) *General rule.* With respect to an annuity contract under section 403(b), except as provided in paragraph (b) of this section, an elective deferral means an employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement within the meaning of section 3121(a)(5)(D).

(b) *Special rule.* Notwithstanding paragraph (a) of this section, for purposes of section 403(b), an elective deferral only includes a contribution that is made pursuant to a cash or deferred election (as defined at §1.401(k)–1(a)(3)). Thus, for purposes of section 402(g)(3)(C), an elective deferral does not include a contribution that is made pursuant to an employee's one-time irrevocable election made on or before the employee's first becoming eligible to participate under the employer's plans or a contribution made as a condition of employment that reduces the employee's compensation.

(c) *Applicable date.* This section is applicable for taxable years beginning after December 31, 2008.

Par. 4. Section 1.402A–1, A–1 is revised to read as follows:

§1.402A–1 Designated Roth Accounts.

* * * * *

A–1. A designated Roth account is a separate account under a qualified cash or deferred arrangement under a section 401(a) plan, or under a section 403(b) plan, to which designated Roth contributions are permitted to be made in lieu of elective contributions and that satisfies the requirements of §1.401(k)–1(f) (in the case of a section 401(a) plan) or §1.403(b)–3(c) (in the case of a section 403(b) plan).

* * * * *

Par. 5. Section 1.403(b)–0 is added to read as follows:

§1.403(b)–0 Taxability under an annuity purchased by a section 501(c)(3) organization or a public school

This section lists the headings that appear in §§1.403(b)–1 through 1.403(b)–11.

§1.403(b)–1 General overview of taxability under an annuity contract purchased by a section 501(c)(3) organization or a public school.

§1.403(b)–2 Definitions.

(a) Application of definitions.
(b) Definitions.

§1.403(b)–3 Exclusion for contributions to purchase section 403(b) contracts.

(a) Exclusion for section 403(b) contracts.
(b) Application of requirements.
(c) Special rules for designated Roth section 403(b) contributions.
(d) Effect of failure.

§1.403(b)–4 Contribution limitations.

(a) Treatment of contributions in excess of limitations.
(b) Maximum annual contribution.
(c) Section 403(b) elective deferrals.
(d) Employer contributions for former employees.
(e) Special rules for determining years of service.
(f) Excess contributions of deferrals.

§1.403(b)–5 Nondiscrimination rules.

(a) Nondiscrimination rules for contributions other than section 403(b) elective deferrals.
(b) Universal availability required for section 403(b) elective deferrals.
(c) Plan required.
(d) Church plans exception.
(e) Other rules.

§1.403(b)–6 Timing of distributions and benefits.

(a) Distributions generally.
(b) Distributions from contracts other than custodial accounts or amounts attributable to section 403(b) elective deferrals.
(c) Distributions from custodial accounts that are not attributable to section 403(b) elective deferrals.
(d) Distribution of section 403(b) elective deferrals.
(e) Minimum required distributions for eligible plans.
(f) Loans.
(g) Death benefits and other incidental benefits.
(h) Special rule regarding severance from employment.

§1.403(b)–7 Taxation of distributions and benefits.

(a) General rules for when amounts are included in gross income.
(b) Rollovers to individual retirement arrangements and other eligible retirement plans.
(c) Special rules for certain corrective distributions.
(d) Amounts taxable under section 72(p)(1).
(e) Special rules relating to distributions from a designated Roth account.
(f) Certain rules relating to employment taxes.

§1.403(b)–8 Funding.

(a) Investments.
(b) Contributions to the plan.
(c) Annuity contracts.
(d) Custodial accounts.
(e) Retirement income accounts.
(f) Combining assets.

§1.403(b)–9 Special rules for church plans.

(a) Retirement income accounts.
(b) Retirement income account defined.
(c) Special deduction rule for self-employed ministers.

§1.403(b)–10 Miscellaneous provisions.

(a) Plan terminations and frozen plans.
(b) Contract exchanges and plan-to-plan transfers.
(c) Qualified domestic relations orders.
(d) Rollovers to a section 403(b) contract.
(e) Deemed IRAs.
(f) Defined benefit plans.
(g) Other rules relating to section 501(c)(3) organizations.

§1.403(b)–11 Applicable date.

(a) General rule.
(b) Collective bargaining agreements.
(c) Church conventions.
(d) Special rules for plans that exclude certain types of employees from elective deferrals.
(e) Special rules for plans that permit in-service distributions.
(f) Special rule for life insurance contracts.

(g) Special rule for contracts received in an exchange.

Par. 6. Sections 1.403(b)–1, 1.403(b)–2, and 1.403(b)–3 are revised to read as follows:

§1.403(b)–1 General overview of taxability under an annuity contract purchased by a section 501(c)(3) organization or a public school.

Section 403(b) and §§1.403(b)–2 through 1.403(b)–10 provide rules for the Federal income tax treatment of an annuity purchased for an employee by an employer that is either a tax-exempt entity under section 501(c)(3) (relating to certain religious, charitable, scientific, or other types of organizations) or a public school, or for a minister described in section 414(e)(5)(A). See section 403(a) (relating to qualified annuities) for rules regarding the taxation of an annuity purchased under a qualified annuity plan that meets the requirements of section 404(a)(2), and see section 403(c) (relating to nonqualified annuities) for rules regarding the taxation of other types of annuities.

§1.403(b)–2 Definitions.

(a) *Application of definitions.* The definitions set forth in this section are applicable for purposes of §1.403(b)–1, this section and §§1.403(b)–3 through 1.403(b)–11.

(b) *Definitions*—(1) *Accumulated benefit* means the total benefit to which a participant or beneficiary is entitled under a section 403(b) contract, including all contributions made to the contract and all earnings thereon.

(2) *Annuity contract* means a contract that is issued by an insurance company qualified to issue annuities in a State and that includes payment in the form of an annuity. See §1.401(f)–1(d)(2) and (e) for the definition of an annuity, and see §1.403(b)–8(c)(3) for a special rule for certain State plans. See also §§1.403(b)–8(d) and 1.403(b)–9(a) for additional rules regarding the treatment of custodial accounts and retirement income accounts as annuity contracts.

(3) *Beneficiary* means a person who is entitled to benefits in respect of a participant following the participant's death or an alternate payee pursuant to a qualified domestic relations order, as described in §1.403(b)–10(c).

(4) *Catch-up* amount or *catch-up* limitation for a participant for a taxable year means a section 403(b) elective deferral permitted under section 414(v) (as described in §1.403(b)–4(c)(2)) or section 402(g)(7) (as described in §1.403(b)–4(c)(3)).

(5) *Church* means a church as defined in section 3121(w)(3)(A) and a qualified church-controlled organization as defined in section 3121(w)(3)(B).

(6) *Church-related organization* means a church or a convention or association of churches, including an organization described in section 414(e)(3)(A).

(7) *Elective deferral* means an elective deferral under §1.402(g)–1 (with respect to an employer contribution to a section 403(b) contract) and any other amount that constitutes an elective deferral under section 402(g)(3).

(8) (i) *Eligible employer* means—

(A) A State, but only with respect to an employee of the State performing services for a public school;

(B) A section 501(c)(3) organization with respect to any employee of the section 501(c)(3) organization;

(C) Any employer of a minister described in section 414(e)(5)(A), but only with respect to the minister; or

(D) A minister described in section 414(e)(5)(A), but only with respect to a retirement income account established for the minister.

(ii) An entity is not an eligible employer under paragraph (a)(8)(i)(A) of this section if it treats itself as not being a State for any other purpose of the Internal Revenue Code, and a subsidiary or other affiliate of an eligible employer is not an eligible employer under paragraph (a)(8)(i) of this section if the subsidiary or other affiliate is not an entity described in paragraph (a)(8)(i) of this section.

(9) *Employee* means a common-law employee performing services for the employer, and does not include a former employee or an independent contractor. Subject to any rules in §1.403(b)–1, this section, and §§1.403(b)–3 through 1.403(b)–11 that are specifically applicable to ministers, an employee also includes a minister described in section 414(e)(5)(A) when performing services in the exercise of his or her ministry.

(10) *Employee performing services for a public school* means an employee performing services as an employee for a public school of a State. This definition is not applicable unless the employee's compensation for performing services for a public school is paid by the State. Further, a person occupying an elective or appointive public office is not an employee performing services for a public school unless such office is one to which an individual is elected or appointed only if the individual has received training, or is experienced, in the field of education. The term *public office* includes any elective or appointive office of a State.

(11) *Includible compensation* means the employee's compensation received from an eligible employer that is includible in the participant's gross income for Federal income tax purposes (computed without regard to section 911) for the most recent period that is a year of service. Includible compensation for a minister who is self-employed means the minister's earned income as defined in section 401(c)(2) (computed without regard to section 911) for the most recent period that is a year of service. Includible compensation does not include any compensation received during a period when the employer is not an eligible employer. Includible compensation also includes any elective deferral or other amount contributed or deferred by the eligible employer at the election of the employee that would be includible in the gross income of the employee but for the rules of sections 125, 132(f)(4), 402(e)(2), 402(h)(1)(B), 402(k), or 457(b). The amount of includible compensation is determined without regard to any community property laws. See section 415(c)(3)(A) through (D) for additional rules, and see §1.403(b)–4(d) for a special rule regarding former employees.

(12) *Participant* means an employee for whom a section 403(b) contract is currently being purchased, or an employee or former employee for whom a section 403(b) contract has previously been purchased and who has not received a distribution of his or her entire accumulated benefit under the contract.

(13) *Plan* means a plan as described in §1.403(b)–3(b)(3).

(14) *Public school* means a State-sponsored educational organization described

in section 170(b)(1)(A)(ii) (relating to educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where educational activities are regularly carried on).

(15) *Retirement income account* means a defined contribution program established or maintained by a church-related organization to provide benefits under section 403(b) for its employees or their beneficiaries as described in §1.403(b)–9.

(16) *Section 403(b) contract; section 403(b) plan*—(i) *Section 403(b) contract* means a contract that satisfies the requirements of §1.403(b)–3. If for any taxable year an employer contributes to more than one section 403(b) contract for a participant or beneficiary, then, under section 403(b)(5), all such contracts are treated as one contract for purposes of section 403(b) and §1.403(b)–1, this section, and §§1.403(b)–3 through 1.403(b)–11. See also §1.403(b)–3(b)(1).

(ii) *Section 403(b) plan* means the plan of the employer under which the section 403(b) contracts for its employees are maintained.

(17) *Section 403(b) elective deferral; designated Roth contribution*—(i) *Section 403(b) elective deferral* means an elective deferral that is an employer contribution to a section 403(b) plan for an employee. See §1.403(b)–5(b) for additional rules with respect to a section 403(b) elective deferral.

(ii) *Designated Roth contribution* under a section 403(b) plan means a section 403(b) elective deferral that satisfies §1.403(b)–3(c).

(18) *Section 501(c)(3) organization* means an organization that is described in section 501(c)(3) (relating to certain religious, charitable, scientific, or other types of organizations) and exempt from tax under section 501(a).

(19) *Severance from employment* means that the employee ceases to be employed by the employer maintaining the plan. See §1.401(k)–1(d) for additional guidance concerning severance from employment. See also §1.403(b)–6(h) for a special rule under which severance from employment is determined by reference to employment with the eligible employer.

(20) *State* means a State, a political subdivision of a State, or any agency or instrumentality of a State. For this purpose, the District of Columbia is treated as a State. In addition, for purposes of determining whether an individual is an employee performing services for a public school, an Indian tribal government is treated as a State, as provided under section 7871(a)(6)(B). See also section 1450(b) of the Small Business Job Protection Act of 1996 (110 Stat. 1755, 1814) for special rules treating certain contracts purchased in a plan year beginning before January 1, 1995, that include contributions by an Indian tribal government as section 403(b) contracts, whether or not those contributions are for employees performing services for a public school.

(21) *Year of service* means each full year during which an individual is a full-time employee of an eligible employer, plus fractional credit for each part of a year during which the individual is either a full-time employee of an eligible employer for a part of the year or a part-time employee of an eligible employer. See §1.403(b)–4(e) for rules for determining years of service.

§1.403(b)–3 Exclusion for contributions to purchase section 403(b) contracts.

(a) *Exclusion for section 403(b) contracts.* Amounts contributed by an eligible employer for the purchase of an annuity contract for an employee are excluded from the gross income of the employee under section 403(b) only if each of the requirements in paragraphs (a)(1) through (9) of this section is satisfied. In addition, amounts contributed by an eligible employer for the purchase of an annuity contract for an employee pursuant to a cash or deferred election (as defined at §1.401(k)–1(a)(3)) are not includible in an employee's gross income at the time the cash would have been includible in the employee's gross income (but for the cash or deferred election) if each of the requirements in paragraphs (a)(1) through (9) of this section is satisfied. However, the preceding two sentences generally do not apply to designated Roth contributions; see paragraph (c) of this section and §1.403(b)–7(e) for special taxation rules that apply with respect to designated Roth contributions under a section 403(b) plan.

(1) *Not a contract issued under qualified plan or eligible governmental plan.* The annuity contract is not purchased under a qualified plan (under section 401(a) or 403(a)) or an eligible governmental plan under section 457(b).

(2) *Nonforfeitability.* The rights of the employee under the annuity contract (disregarding rights to future premiums) are nonforfeitable. An employee's rights under a contract fail to be nonforfeitable unless the employee for whom the contract is purchased has at all times a fully vested and nonforfeitable right (as defined in regulations under section 411) to all benefits provided under the contract. See paragraph (d)(2) of this section for additional rules regarding the nonforfeitability requirement of this paragraph (a)(2).

(3) *Nondiscrimination.* In the case of an annuity contract purchased by an eligible employer other than a church, the contract is purchased under a plan that satisfies section 403(b)(12) (relating to nondiscrimination requirements, including universal availability). See §1.403(b)–5.

(4) *Limitations on elective deferrals.* In the case of an elective deferral, the contract satisfies section 401(a)(30) (relating to limitations on elective deferrals). A contract does not satisfy section 401(a)(30) as required under this paragraph (a)(4) unless the contract requires that all elective deferrals for an employee not exceed the limits of section 402(g)(1), including elective deferrals for the employee under the contract and any other elective deferrals under the plan under which the contract is purchased and under all other plans, contracts, or arrangements of the employer. See §1.401(a)–30.

(5) *Nontransferability.* The contract is not transferable. This paragraph (a)(5) does not apply to a contract issued before January 1, 1963. See section 401(g).

(6) *Minimum required distributions.* The contract satisfies the requirements of section 401(a)(9) (relating to minimum required distributions). See §1.403(b)–6(e).

(7) *Rollover distributions.* The contract provides that, if the distributee of an eligible rollover distribution elects to have the distribution paid directly to an eligible retirement plan, as defined in section 402(c)(8)(B), and specifies the eligible retirement plan to which the distribution is to be paid, then the distribution will be paid to that eligible retirement plan in a direct rollover. See §1.403(b)–7(b)(2).

(8) *Limitation on incidental benefits.* The contract satisfies the incidental benefit requirements of section 401(a). See §1.403(b)–6(g).

(9) *Maximum annual additions.* The annual additions to the contract do not exceed the applicable limitations of section 415(c) (treating contributions and other additions as annual additions). See paragraph (b) of this section and §1.403(b)–4(b) and (f).

(b) *Application of requirements*—(1) *Aggregation of contracts.* In accordance with section 403(b)(5), for purposes of determining whether this section is satisfied, all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract. Additional aggregation rules apply under section 402(g) for purposes of satisfying paragraph (a)(4) of this section and under section 415 for purposes of satisfying paragraph (a)(9) of this section.

(2) *Disaggregation for excess annual additions.* In accordance with the last sentence of section 415(a)(2), if an excess annual addition is made to a contract that otherwise satisfies the requirements of this section, then the portion of the contract that includes such excess annual addition fails to be a section 403(b) contract (as further described in paragraph (d)(1) of this section) and the remaining portion of the contract is a section 403(b) contract. This paragraph (b)(2) is not satisfied unless, for the year of the excess and each year thereafter, the issuer of the contract maintains separate accounts for each such portion. Thus, the entire contract fails to be a section 403(b) contract if an excess annual addition is made and a separate account is not maintained with respect to the excess.

(3) *Plan in form and operation.* (i) A contract does not satisfy paragraph (a) of this section unless it is maintained pursuant to a plan. For this purpose, a plan is a written defined contribution plan, which, in both form and operation, satisfies the requirements of §1.403(b)–1, §1.403(b)–2, this section, and §§1.403(b)–4 through 1.403(b)–11. For purposes of §1.403(b)–1, §1.403(b)–2, this section, and §§1.403(b)–4 through 1.403(b)–11, the plan must contain all the material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made. For purposes of §1.403(b)–1, §1.403(b)–2, this section, and §§1.403(b)–4 through 1.403(b)–11, a plan may contain certain optional features that are consistent with but not required under section 403(b), such as hardship withdrawal distributions, loans, plan-to-plan or annuity contract-to-annuity contract transfers, and acceptance of rollovers to the plan. However, if a plan contains any optional provisions, the optional provisions must meet, in both form and operation, the relevant requirements under section 403(b), this section, and §§1.403(b)–4 through 1.403(b)–11.

(ii) The plan may allocate responsibility for performing administrative functions, including functions to comply with the requirements of section 403(b) and other tax requirements. Any such allocation must identify responsibility for compliance with the requirements of the Internal Revenue Code that apply on the basis of the aggregated contracts issued to a participant under a plan, including loans under section 72(p) and the conditions for obtaining a hardship withdrawal under §1.403(b)–6. A plan is permitted to assign such responsibilities to parties other than the eligible employer, but not to participants (other than employees of the employer a substantial portion of whose duties are administration of the plan), and may incorporate by reference other documents, including the insurance policy or custodial account, which thereupon become part of the plan.

(iii) This paragraph (b)(3) applies to contributions to an annuity contract by a church only if the annuity is part of a retirement income account, as defined in §1.403(b)–9.

(4) *Exclusion limited for former employees*—(i) *General rule.* Except as provided in paragraph (b)(4)(ii) of this section and in §1.403(b)–4(d), the exclusion from gross income provided by section 403(b) does not apply to contributions made for former employees. For this purpose, a contribution is not made for a former employee if the contribution is with respect to compensation that would otherwise be paid for a payroll period that begins before severance from employment.

(ii) *Exceptions.* The exclusion from gross income provided by section 403(b) applies to contributions made for former employees with respect to compensation described in §1.415(c)–2(e)(3)(i) (relating to certain compensation paid by the later of $2^1/_2$ months after severance from employment or the end of the limitation year that includes the date of severance from employment), and compensation described in §1.415(c)–2(e)(4), §1.415(c)–2(g)(4), or §1.415(c)–2(g)(7) (relating to compensation paid to participants who are permanently and totally disabled or relating to qualified military service under section 414(u)).

(c) *Special rules for designated Roth section 403(b) contributions.* (1) The rules of §1.401(k)–1(f)(1) and (2) for designated Roth contributions under a qualified cash or deferred arrangement apply to designated Roth contributions under a section 403(b) plan. Thus, a designated Roth contribution under a section 403(b) plan is a section 403(b) elective deferral that is designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution that is being made in lieu of all or a portion of the section 403(b) elective deferrals the employee is otherwise eligible to make under the plan; that is treated by the employer as includible in the employee's gross income at the time the employee would have received the amount in cash if the employee had not made the cash or deferred election (such as by treating the contributions as wages subject to applicable withholding requirements); and that is maintained in a separate account (within the meaning of §1.401(k)–1(f)(2)).

(2) A designated Roth contribution under a section 403(b) plan must satisfy the requirements applicable to section 403(b) elective deferrals. Thus, for example, designated Roth contributions under a section 403(b) plan must satisfy the requirements of §1.403(b)–6(d). Similarly, a designated Roth account under a section 403(b) plan is subject to the rules of sections 401(a)(9)(A) and (B) and §1.403(b)–6(e).

(d) *Effect of failure*—(1) *General rules.* (i) If a contract includes any amount that fails to satisfy the requirements of section 403(b), §1.403(b)–1, §1.403(b)–2, this section, or §§1.403(b)–4 through 1.403(b)–11, then, except as otherwise provided in paragraph (d)(2) of this section (relating to failure to satisfy nonforfeitability requirements) or §1.403(b)–4(f) (relating to excess contributions under section 415 and excess deferrals under section 402(g)), the contract is not a sec-

tion 403(b) contract. In addition, section 403(b)(5) and paragraph (b)(1) of this section provide that, for purposes of determining whether a contract satisfies section 403(b), all section 403(b) contracts purchased for an individual by an employer are treated as purchased under a single contract. Thus, except as provided in paragraph (b)(2) of this section or as otherwise provided in this paragraph (d), a failure to satisfy section 403(b) with respect to any contract issued to an individual by an employer adversely affects all contracts issued to that individual by that employer.

(ii) In accordance with paragraph (b)(3) of this section, a failure to operate in accordance with the terms of a plan adversely affects all of the contracts issued by the employer to the employee or employees with respect to whom the operational failure occurred. Such a failure does not adversely affect any other contract if the failure is neither a failure to satisfy the nondiscrimination requirements of §1.403(b)–5 (a nondiscrimination failure) nor a failure of the employer to be an eligible employer as defined in §1.403(b)–2 (an employer eligibility failure). However, any failure that is not an operational failure adversely affects all contracts issued under the plan, including: a failure to have contracts issued pursuant to a written defined contribution plan which, in form, satisfies the requirements of §1.403(b)–1, §1.403(b)–2, this section, and §§1.403(b)–4 through 1.403(b)–11 (a written plan failure); a nondiscrimination failure; or an employer eligibility failure.

(iii) See other applicable Internal Revenue Code provisions for the treatment of a contract that is not a section 403(b) contract, such as sections 61, 83, 402(b), and 403(c). Thus, for example, section 403(c) (relating to nonqualified annuities) applies if any annuity contract issued by an insurance company fails to satisfy section 403(b), based on the value of the contract at the time of the failure. However, see paragraph (d)(2) of this section for special rules with respect to the nonforfeitability requirement of paragraph (a)(2) of this section.

(2) *Failure to satisfy nonforfeitability requirement*—(i) *Treatment before contract becomes nonforfeitable.* If an annuity contract issued by an insurance company would qualify as a section 403(b) contract but for the failure to satisfy the nonforfeitability requirement of paragraph (a)(2) of this section, then the contract is treated as a contract to which section 403(c) applies. See §1.403(b)–8(d)(4) for a rule under which a custodial account that fails to satisfy the nonforfeitability requirement of paragraph (a)(2) of this section is treated as a section 401(a) qualified plan for certain purposes.

(ii) *Treatment when contract becomes nonforfeitable*—(A) *In general.* Notwithstanding paragraph (d)(2)(i) of this section, on or after the date on which the participant's interest in a contract described in paragraph (d)(2)(i) of this section becomes nonforfeitable, the contract may be treated as a section 403(b) contract if no election has been made under section 83(b) with respect to the contract, the participant's interest in the contract has been subject to a substantial risk of forfeiture (as defined in section 83) before becoming nonforfeitable, each contribution under the contract that is subject to a different vesting schedule is maintained in a separate account, and the contract has at all times satisfied the requirements of paragraph (a) of this section other than the nonforfeitability requirement of paragraph (a)(2) of this section. Thus, for example, for the current year and each prior year, no contribution can have been made to the contract that would cause the contract to fail to be a section 403(b) contract as a result of contributions exceeding the limitations of section 415 (except to the extent permitted under paragraph (b)(2) of this section) or to fail to satisfy the nondiscrimination rules described in §1.403(b)–5. See also §1.403(b)–10(a)(1) for a special rule in connection with termination of a section 403(b) plan.

(B) *Partial vesting.* For purposes of applying this paragraph (d), if only a portion of a participant's interest in a contract becomes nonforfeitable in a year, then the portion that is nonforfeitable and the portion that fails to be nonforfeitable are each treated as separate contracts. In addition, for purposes of applying this paragraph (d), if a contribution is made to an annuity contract in excess of the limitations of section 415(c) and the excess is maintained in a separate account, then the portion of the contract that includes the excess contributions account and the remainder are each treated as separate contracts. Thus, if an annuity contract that includes an excess contributions account changes from forfeitable to nonforfeitable during a year, then the portion that is not attributable to the excess contributions account constitutes a section 403(b) contract (assuming it otherwise satisfies the requirements to be a section 403(b) contract) and is not included in gross income, and the portion that is attributable to the excess contributions account is included in gross income in accordance with section 403(c). See §1.403(b)–4(f) for additional rules.

Par. 7. Sections 1.403(b)–4, 1.403(b)–5, 1.403(b)–6, 1.403(b)–7, 1.403(b)–8, 1.403(b)–9, 1.403(b)–10, and 1.403(b)–11 are added to read as follows:

§1.403(b)–4 Contribution limitations.

(a) *Treatment of contributions in excess of limitations.* The exclusion provided under §1.403(b)–3(a) applies to a participant only if the amounts contributed by the employer for the purchase of an annuity contract for the participant do not exceed the applicable limit under sections 415 and 402(g), as described in this section. Under §1.403(b)–3(a)(4), a section 403(b) contract is required to include the limits on elective deferrals imposed by section 402(g), as described in paragraph (c) of this section. See paragraph (f) of this section for special rules concerning excess contributions and deferrals. Rollover contributions made to a section 403(b) contract, as described in §1.403(b)–10(d), are not taken into account for purposes of the limits imposed by section 415, §1.403(b)–3(a)(9), section 402(g), §1.403(b)–3(a)(4), and this section, but after-tax employee contributions are taken into account under section 415, §1.403(b)–3(a)(9), and paragraph (b) of this section.

(b) *Maximum annual contribution*—(1) *General rule.* In accordance with section 415(a)(2) and §1.403(b)–3(a)(9), the contributions for any participant under a section 403(b) contract (namely, employer nonelective contributions (including matching contributions), section 403(b) elective deferrals, and after-tax employee contributions) are not permitted to exceed the limitations imposed by section 415. Under section 415(c), contributions are permitted to be made for participants in a defined contribution

plan, subject to the limitations set forth therein (which are generally the lesser of a dollar limit for a year or the participant's compensation for the year). For purposes of section 415, contributions made for a participant are aggregated to the extent applicable under section 414(b), (c), (m), (n), and (o). For purposes of sections 415(a)(2), §§1.403(b)–1 through 1.403(b)–3, this section, and §§1.403(b)–5 through 1.403(b)–11, a contribution means any annual addition, as defined in section 415(c).

(2) *Special rules.* See section 415(k)(4) for a special rule under which contributions to section 403(b) contracts are generally aggregated with contributions under other arrangements in applying section 415. For purposes of applying section 415(c)(1)(B) (relating to compensation) with respect to a section 403(b) contract, except as provided in section 415(c)(3)(C), a participant's includible compensation (as defined in §1.403(b)–2) is substituted for the participant's compensation, as described in section 415(c)(3)(E). Any age 50 catch-up contributions under paragraph (c)(2) of this section are disregarded in applying section 415.

(c) *Section 403(b) elective deferrals*—(1) *Basic limit under section 402(g)(1).* In accordance with section 402(g)(1)(A), the section 403(b) elective deferrals for any individual are included in the individual's gross income to the extent the amount of such deferrals, plus all other elective deferrals for the individual, for the taxable year exceeds the applicable dollar amount under section 402(g)(1)(B). The applicable annual dollar amount under section 402(g)(1)(B) is $15,000, adjusted for cost-of-living after 2006 in the manner described in section 402(g)(4). See §1.403(b)–5(b) for a universal availability rule that applies if any employee is permitted to have any section 403(b) elective deferrals made on his or her behalf.

(2) *Age 50 catch-up*—(i) *In general.* In accordance with section 414(v) and the regulations thereunder, a section 403(b) contract may provide for catch-up contributions for a participant who is age 50 by the end of the year, provided that such age 50 catch-up contributions do not exceed the catch-up limit under section 414(v)(2) for the taxable year. The maximum amount of additional age 50 catch-up contributions for a taxable year under section 414(v) is $5,000, adjusted for cost-of-living after 2006 in the manner described in section 414(v)(2)(C). For additional requirements, see regulations under section 414(v).

(ii) *Coordination with special section 403(b) catch-up.* In accordance with sections 414(v)(6)(A)(ii) and 402(g)(7)(A), the age 50 catch-up described in this paragraph (c)(2) may apply for any taxable year in which a participant also qualifies for the special section 403(b) catch-up under paragraph (c)(3) of this section.

(3) *Special section 403(b) catch-up for certain organizations*—(i) *Amount of the special section 403(b) catch-up.* In the case of a qualified employee of a qualified organization for whom the basic section 403(b) elective deferrals for any year are not less than the applicable dollar amount under section 402(g)(1)(B), the section 403(b) elective deferral limitation of section 402(g)(1) for the taxable year of the qualified employee is increased by the least of—

(A) $3,000;

(B) The excess of—

(*1*) $15,000, over

(*2*) The total elective deferrals described in section 402(g)(7)(A)(ii) made for the qualified employee by the qualified organization for prior years; or

(C) The excess of—

(*1*) $5,000 multiplied by the number of years of service of the employee with the qualified organization, over

(*2*) The total elective deferrals (as defined at §1.403(b)–2) made for the employee by the qualified organization for prior years.

(ii) *Qualified organization.* (A) For purposes of this paragraph (c)(3), *qualified organization* means an eligible employer that is—

(*1*) An educational organization described in section 170(b)(1)(A)(ii);

(*2*) A hospital;

(*3*) A health and welfare service agency (including a home health service agency);

(*4*) A church-related organization; or

(*5*) Any organization described in section 414(e)(3)(B)(ii).

(B) All entities that are in a church-related organization or an organization controlled by a church-related organization under section 414(e)(3)(B)(ii) are treated as a single qualified organization (so that years of service and any special section 403(b) catch-up elective deferrals previously made for a qualified employee for a church or other entity within a church-related organization or an organization controlled by the church-related organization are taken into account for purposes of applying this paragraph (c)(3) to the employee with respect to any other entity within the same church-related organization or organization controlled by a church-related organization).

(C) For purposes of this paragraph (c)(3)(ii), a *health and welfare service agency* means—

(*1*) An organization whose primary activity is to provide services that constitute medical care as defined in section 213(d)(1) (such as a hospice);

(*2*) A section 501(c)(3) organization whose primary activity is the prevention of cruelty to individuals or animals;

(*3*) An adoption agency; or

(*4*) An agency that provides substantial personal services to the needy as part of its primary activity (such as a section 501(c)(3) organization that either provides meals to needy individuals, is a home health service agency, provides services to help individuals who have substance abuse, or provides help to the disabled).

(iii) *Qualified employee.* For purposes of this paragraph (c)(3), *qualified employee* means an employee who has completed at least 15 years of service (as defined under paragraph (e) of this section) taking into account only employment with the qualified organization. Thus, an employee who has not completed at least 15 years of service (as defined under paragraph (e) of this section) taking into account only employment with the qualified organization is not a qualified employee.

(iv) *Coordination with age 50 catch-up.* In accordance with sections 402(g)(1)(C) and 402(g)(7), any catch-up amount contributed by an employee who is eligible for both an age 50 catch-up and a special section 403(b) catch-up is treated first as an amount contributed as a special section 403(b) catch-up to the extent a special section 403(b) catch-up is permitted, and then as an amount contributed as an age 50 catch-up (to the extent the catch-up amount exceeds the maximum special section 403(b) catch-up after taking into account sections 402(g) and 415(c), this paragraph (c)(3), and any limitations on

the special section 403(b) catch-up that are imposed by the terms of the plan).

(4) *Coordination with designated Roth contributions.* See regulations under section 402A for rules for determining whether an elective deferral is a pre-tax elective deferral or a designated Roth contribution.

(5) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. (i) *Facts illustrating application of the basic dollar limit.* Participant B, who is 45, is eligible to participate in a State university section 403(b) plan in 2006. B is not a qualified employee, as defined in paragraph (c)(3)(iii) of this section. The plan permits section 403(b) elective deferrals, but no other employer contributions are made under the plan. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1) and (3) of this section and the additional age 50 catch-up amount described in paragraph (c)(2) of this section. For 2006, B will receive includible compensation of $42,000 from the eligible employer. B desires to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is $15,000 and the additional dollar amount permitted under the age 50 catch-up is $5,000.

(ii) *Conclusion.* B is not eligible for the age 50 catch-up in 2006 because B is 45 in 2006. B is also not eligible for the special section 403(b) catch-up under paragraph (c)(3) of this section because B is not a qualified employee. Accordingly, the maximum section 403(b) elective deferral that B may elect for 2006 is $15,000.

Example 2. (i) *Facts illustrating application of the includible compensation limitation.* The facts are the same as in *Example 1*, except B's includible compensation is $14,000.

(ii) *Conclusion.* Under section 415(c), contributions may not exceed 100 percent of includible compensation. Accordingly, the maximum section 403(b) elective deferral that B may elect for 2006 is $14,000.

Example 3. (i) *Facts illustrating application of the age 50 catch-up.* Participant C, who is 55, is eligible to participate in a State university section 403(b) plan in 2006. The plan permits section 403(b) elective deferrals, but no other employer contributions are made under the plan. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1) and (c)(3) of this section and the additional age 50 catch-up amount described in paragraph (c)(2) of this section. For 2006, C will receive includible compensation of $48,000 from the eligible employer. C desires to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is $15,000 and the additional dollar amount permitted under the age 50 catch-up is $5,000. C does not have 15 years of service and thus is not a qualified employee, as defined in paragraph (c)(3)(iii) of this section.

(ii) *Conclusion.* C is eligible for the age 50 catch-up in 2006 because C is 55 in 2006. C is not eligible for the special section 403(b) catch-up under paragraph (c)(3) of this section because C is not a qualified employee (as defined in paragraph (c)(3)(iii) of this section). Accordingly, the maximum section 403(b) elective deferral that C may elect for 2006 is $20,000 ($15,000 plus $5,000).

Example 4. (i) *Facts illustrating application of both the age 50 and the special section 403(b) catch-up.* The facts are the same as in *Example 3*, except that C is a qualified employee for purposes of the special section 403(b) catch-up provisions in paragraph (c)(3) of this section. For 2006, the maximum additional section 403(b) elective deferral for which C qualifies under the special section 403(b) catch-up under paragraph (c)(3) of this section is $3,000.

(ii) *Conclusion.* The maximum section 403(b) elective deferrals that C may elect for 2006 is $23,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to $15,000, plus the $3,000 additional special section 403(b) catch-up amount for which C qualifies under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of $5,000.

Example 5. (i) *Facts illustrating calculation of years of service with a predecessor organization for purposes of the special section 403(b) catch-up.* Participant A is an employee of hospital H and is eligible to participate in a section 403(b) plan of H in 2006. A does not have 15 years of service with H, but A has previously made special section 403(b) catch-up deferrals to a section 403(b) plan maintained by hospital P which has since been acquired by H.

(ii) *Conclusion.* The special section 403(b) catch-up amount for which A qualifies under paragraph (c)(3) of this section must be calculated taking into account A's prior years of service and section 403(b) elective deferrals with the predecessor hospital if and only if A did not have any severance from service in connection with the acquisition.

Example 6. (i) *Facts illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 4*, except that the employer makes a nonelective contribution for each employee equal to 20 percent of C's compensation (which is $48,000). Thus, the employer makes a nonelective contribution for C for 2006 equal to $9,600. The plan provides that a participant is not permitted to make section 403(b) elective deferrals to the extent the section 403(b) elective deferrals would result in contributions in excess of the maximum permitted under section 415 and provides that contributions are reduced in the following order: the special section 403(b) catch-up elective deferrals under paragraph (c)(3) of this section are reduced first; the age 50 catch-up elective deferrals under paragraph (c)(2) of this section are reduced second; and then the basic section 403(b) elective deferrals under paragraph (c)(1) of this section are reduced. For 2006, the applicable dollar limit under section 415(c)(1)(A) is $44,000.

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is $23,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to $15,000, plus the $3,000 additional special section 403(b) catch-up amount for which C qualifies under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of $5,000. The limit in paragraph (b) of this section would not be exceeded because the sum of the $9,600 nonelective contribution and the $23,000 section 403(b) elective deferrals does not exceed the lesser of $49,000 (which is the sum of $44,000 plus the $5,000 additional age 50 catch-up amount) or $53,000 (which is the sum of C's includible compensation for 2006 ($48,000) plus the $5,000 additional age 50 catch-up amount).

Example 7. (i) *Facts further illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 6*, except that C's includible compensation for 2006 is $58,000 and the plan provides for a nonelective contribution equal to 50 percent of includible compensation, so that the employer nonelective contribution for C for 2006 is $29,000 (50 percent of $58,000).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is $20,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(A) plus the additional age 50 catch-up amount, because the sum of the employer's nonelective contribution of $29,000 plus a section 403(b) elective deferral in excess of $20,000 would exceed $49,000 (the sum of the $44,000 limit in section 415(c)(1)(A) plus the $5,000 additional age 50 catch-up amount). (Note that a section 403(b) elective deferral in excess of $20,000 would also exceed the limitations of section 402(g) unless a special section 403(b) catch-up were permitted.)

Example 8. (i) *Facts further illustrating application of the age 50 catch-up and the section 415(c) dollar limitation.* The facts are the same as in *Example 7*, except that the plan provides for a nonelective contribution for C equal to $44,000 (which is the limit in section 415(c)(1)(A)).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is $5,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(A) plus the additional age 50 catch-up amount ($5,000), because the sum of the employer's nonelective contribution of $44,000 plus a section 403(b) elective deferral in excess of $5,000 would exceed $49,000 (the sum of the $44,000 limit in section 415(c)(1)(A) plus the $5,000 additional age 50 catch-up amount).

Example 9. (i) *Facts illustrating application of the age 50 catch-up and the section 415(c) includible compensation limitation.* The facts are the same as in *Example 7*, except that C's includible compensation for 2006 is $28,000, so that the employer nonelective contribution for C for 2006 is $14,000 (50 percent of $28,000).

(ii) *Conclusion.* The maximum section 403(b) elective deferral that C may elect for 2006 is $19,000. A section 403(b) elective deferral in excess of this amount would exceed the sum of the limit in section 415(c)(1)(B) plus the additional age 50 catch-up amount, because C's includible compensation is $28,000 and the sum of the employer's nonelective contribution of $14,000 plus a section 403(b) elective deferral in excess of $19,000 would exceed $33,000 (which is the sum of 100 percent of C's includible compensation plus the $5,000 additional age 50 catch-up amount).

Example 10. (i) *Facts illustrating that section 403(b) elective deferrals cannot exceed compensation otherwise payable.* Employee D is age 60, has in-

cludible compensation of $14,000, and wishes to contribute section 403(b) elective deferrals of $20,000 for the year. No nonelective contributions are made for Employee D.

(ii) *Conclusion.* Because a contribution is a section 403(b) elective deferral only if it relates to an amount that would otherwise be included in the participant's compensation, the effective limitation on section 403(b) elective deferrals for a participant whose compensation is less than the basic dollar limit for section 403(b) elective deferrals is the participant's compensation. Thus, D cannot make section 403(b) elective deferrals in excess of D's actual compensation, which is $14,000, even though the basic dollar limit exceeds that amount.

Example 11. (i) *Facts illustrating calculation of the special section 403(b) catch-up.* For 2006, employee E, who is age 53, is eligible to participate in a section 403(b) plan of hospital H, which is a section 501(c)(3) organization. H's plan permits section 403(b) elective deferrals and provides for an employer contribution of 10 percent of a participant's compensation. The plan provides limitations on section 403(b) elective deferrals up to the maximum permitted under paragraphs (c)(1), (2), and (3) of this section. For 2006, E's includible compensation is $50,000. E wishes to elect to have the maximum section 403(b) elective deferral possible contributed in 2006. E has previously made $62,000 of section 403(b) elective deferrals under the plan, but has never made an election for a special section 403(b) catch-up elective deferral. For 2006, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is $15,000, the additional dollar amount permitted under the age 50 catch-up is $5,000, E's employer will make a nonelective contribution of $5,000 (10% of $50,000 compensation), and E is a qualified employee of a qualified employer as defined in paragraph (c)(3) of this section.

(ii) *Conclusion.* The maximum section 403(b) elective deferrals that E may elect under H's section 403(b) plan for 2006 is $23,000. This is the sum of the basic limit on section 403(b) elective deferrals for 2006 under paragraph (c)(1) of this section equal to $15,000, plus the $3,000 maximum additional special section 403(b) catch-up amount for which D qualifies in 2006 under paragraph (c)(3) of this section, plus the additional age 50 catch-up amount of $5,000. The limitation on the additional special section 403(b) catch-up amount is not less than $3,000 because the limitation at paragraph (c)(3)(i)(B) of this section is $15,000 ($15,000 minus zero) and the limitation at paragraph (c)(3)(i)(C) of this section is $13,000 ($5,000 times 15, minus $62,000 of total deferrals in prior years). These conclusions would be unaffected if H were an eligible governmental employer under section 457(b) that has a section 457(b) eligible governmental plan and E were in the past to have made annual deferrals to that plan, because contributions to a section 457(b) eligible governmental plan do not constitute elective deferrals; and these conclusions would also be the same if H had a section 401(k) plan and E were in the past to have made elective deferrals to that plan, assuming that those elective deferrals did not exceed $10,000 ($5,000 times 15, minus the sum of $62,000 plus $10,000, equals $3,000), so as to result in the limitation at paragraph (c)(3)(i)(C) of this section being less than $3,000.

Example 12. (i) *Facts illustrating calculation of the special section 403(b) catch-up in the next calendar year.* The facts are the same as in *Example 11*, except that, for 2007, E has includible compensation of $60,000. For 2007, E now has previously made $85,000 of section 403(b) elective deferrals ($62,000 deferred before 2006, plus the $15,000 in basic section 403(b) elective deferrals in 2006, the $3,000 maximum additional special section 403(b) catch-up amount in 2006, plus the $5,000 age 50 catch-up amount in 2006). However, the $5,000 age 50 catch-up amount deferred in 2006 is disregarded for purposes of applying the limitation at paragraph (c)(3)(i)(B) of this section to determine the special section 403(b) catch-up amount. Thus, for 2007, only $80,000 of section 403(b) elective deferrals are taken into account in applying the limitation at paragraph (c)(3)(i)(B) of this section. For 2007, the basic dollar limit for section 403(b) elective deferrals under paragraph (c)(1) of this section is assumed to be $16,000, the additional dollar amount permitted under the age 50 catch-up is assumed to be $5,000, and E's employer contributes $6,000 (10% of $60,000) as a non-elective contribution.

(ii) *Conclusion.* The maximum section 403(b) elective deferral that D may elect under H's section 403(b) plan for 2007 is $21,000. This is the sum of the basic limit on section 403(b) elective deferrals under paragraph (c)(1) of this section equal to $16,000, plus the additional age 50 catch-up amount of $5,000. E is not entitled to any additional special section 403(b) catch-up amount for 2007 under paragraph (c)(3) of this section due to the limitation at paragraph (c)(3)(i)(C) of this section (16 times $5,000 equals $80,000, minus D's total prior section 403(b) elective deferrals of $80,000 equals zero).

(d) *Employer contributions for former employees*—(1) *Includible compensation deemed to continue for nonelective contributions.* For purposes of applying paragraph (b) of this section, a former employee is deemed to have monthly includible compensation for the period through the end of the taxable year of the employee in which he or she ceases to be an employee and through the end of each of the next five taxable years. The amount of the monthly includible compensation is equal to one twelfth of the former employee's includible compensation during the former employee's most recent year of service. Accordingly, nonelective employer contributions for a former employee must not exceed the limitation of section 415(c)(1) up to the lesser of the dollar amount in section 415(c)(1)(A) or the former employee's annual includible compensation based on the former employee's average monthly compensation during his or her most recent year of service.

(2) *Examples.* The provisions of paragraph (d)(1) of this section are illustrated by the following examples:

Example 1. (i) *Facts.* Private college M is a section 501(c)(3) organization operated on the basis of a June 30 fiscal year that maintains a section 403(b) plan for its employees. In 2004, M amends the plan to provide for a temporary early retirement incentive under which the college will make a nonelective contribution for any participant who satisfies certain minimum age and service conditions and who retires before June 30, 2006. The contribution will equal 110 percent of the participant's rate of pay for one year and will be payable over a period ending no later than the end of the fifth fiscal year that begins after retirement. It is assumed for purposes of this *Example 1* that, in accordance with §1.401(a)(4)–10(b) and under the facts and circumstances, the post-retirement contributions made for participants who satisfy the minimum age and service conditions and retire before June 30, 2006, do not discriminate in favor of former employees who are highly compensated employees. Employee A retires under the early retirement incentive on March 12, 2006, and A's annual includible compensation for the period from March 1, 2005, through February 28, 2006 (which is A's most recent one year of service) is $30,000. The applicable dollar limit under section 415(c)(1)(A) is assumed to be $44,000 for 2006 and $45,000 for 2007. The college contributes $30,000 for A for 2006 and $3,000 for A for 2007 (totaling $33,000 or 110 percent of $30,000). No other contributions are made to a section 403(b) contract for A for those years.

(ii) *Conclusion.* The contributions made for A do not exceed A's includible compensation for 2006 or 2007.

Example 2. (i) *Facts.* Private college N is a section 501(c)(3) organization that maintains a section 403(b) plan for its employees. The plan provides for N to make monthly nonelective contributions equal to 20 percent of the monthly includible compensation for each eligible employee. In addition, the plan provides for contributions to continue for 5 years following the retirement of any employee after age 64 and completion of at least 20 years of service (based on the employee's average annual rate of base salary in the preceding 3 calendar years ended before the date of retirement). It is assumed for purposes of this *Example 2* that, in accordance with §1.401(a)(4)–10(b) and under the facts and circumstances, the post-retirement contributions made for participants who satisfy the minimum age and service conditions do not discriminate in favor of former employees who are highly compensated employees. Employee B retires on July 1, 2006, at age 64 after completion of 20 or more years of service. At that date, B's annual includible compensation for the most recently ended fiscal year of N is $72,000 and B's average monthly rate of base salary for 2003 through 2005 is $5,000. N contributes $1,200 per month (20 percent of 1/12th of $72,000) from January of 2006 through June of 2006 and contributes $1,000 (20 percent of $5,000) per month for B from July of 2006 through June of 2011. The applicable dollar limit under section 415(c)(1)(A) is $44,000 for 2006 through 2011. No other contributions are made to a section 403(b) contract for B for those years.

(ii) *Conclusion.* The contributions made for B do not exceed B's includible compensation for any of the years from 2006 through 2010.

Example 3. (i) *Facts.* A public university maintains a section 403(b) plan under which it contributes

annually 10% of compensation for participants, including for the first 5 calendar years following the date on which the participant ceases to be an employee. The plan provides that if a participant who is a former employee dies during the first 5 calendar years following the date on which the participant ceases to be an employee, a contribution is made that is equal to the lesser of —

(A) The excess of the individual's includible compensation for that year over the contributions previously made for the individual for that year; or

(B) The total contributions that would have been made on the individual's behalf thereafter if he or she had survived to the end of the 5-year period.

(ii) Individual C's annual includible compensation is $72,000 (so that C's monthly includible compensation is $6,000). A $600 contribution is made for C for January of the first taxable year following retirement (10% of individual C's monthly includible compensation of $6,000). Individual C dies during February of that year. The university makes a contribution for individual C for February equal to $11,400 (C's monthly includible compensation for January and February, reduced by $600).

(iii) *Conclusion.* The contribution does not exceed the amount of individual C's includible compensation for the taxable year for purposes of section 415(c), but any additional contributions would exceed C's includible compensation for purposes of section 415(c).

(3) *Disabled employees.* See also section 415(c)(3)(C) which sets forth a special rule under which compensation may be treated as continuing for purposes of section 415 for certain former employees who are disabled.

(e) *Special rules for determining years of service*—(1) *In general.* For purposes of determining a participant's includible compensation under paragraph (b)(2) of this section and a participant's years of service under paragraphs (c)(3) (special section 403(b) catch-up for qualified employees of certain organizations) and (d) (employer contributions for former employees) of this section, an employee must be credited with a full year of service for each year during which the individual is a full-time employee of the eligible employer for the entire work period, and a fraction of a year for each part of a work period during which the individual is a full-time or part-time employee of the eligible employer. An individual's number of years of service equals the aggregate of the annual work periods during which the individual is employed by the eligible employer.

(2) *Work period.* A year of service is based on the employer's annual work period, not the employee's taxable year. For example, in determining whether a university professor is employed full time, the annual work period is the school's academic year. However, in no case may an employee accumulate more than one year of service in a twelve-month period.

(3) *Service with more than one eligible employer*—(i) *General rule.* With respect to any section 403(b) contract of an eligible employer, except as provided in paragraph (e)(3)(ii) of this section, any period during which an individual is not an employee of that eligible employer is disregarded for purposes of this paragraph (e).

(ii) *Special rule for church employees.* With respect to any section 403(b) contract of an eligible employer that is a church-related organization, any period during which an individual is an employee of that eligible employer and any other eligible employer that is a church-related organization that has an association (as defined in section 414(e)(3)(D)) with that eligible employer is taken into account on an aggregated basis, but any period during which an individual is not an employee of a church-related organization or is an employee of a church-related organization that does not have an association with that eligible employer is disregarded for purposes of this paragraph (e).

(4) *Full-time employee for full year.* Each annual work period during which an individual is employed full time by the eligible employer constitutes one year of service. In determining whether an individual is employed full-time, the amount of work which he or she actually performs is compared with the amount of work that is normally required of individuals performing similar services from which substantially all of their annual compensation is derived.

(5) *Other employees.* (i) An individual is treated as performing a fraction of a year of service for each annual work period during which he or she is a full-time employee for part of the annual work period and for each annual work period during which he or she is a part-time employee either for the entire annual work period or for a part of the annual work period.

(ii) In determining the fraction that represents the fractional year of service for an individual employed full time for part of an annual work period, the numerator is the period of time (such as weeks or months) during which the individual is a full-time employee during that annual work period, and the denominator is the period of time that is the annual work period.

(iii) In determining the fraction that represents the fractional year of service of an individual who is employed part time for the entire annual work period, the numerator is the amount of work performed by the individual, and the denominator is the amount of work normally required of individuals who perform similar services and who are employed full time for the entire annual work period.

(iv) In determining the fraction representing the fractional year of service of an individual who is employed part time for part of an annual work period, the fractional year of service that would apply if the individual were a part-time employee for a full annual work period is multiplied by the fractional year of service that would apply if the individual were a full-time employee for the part of an annual work period.

(6) *Work performed.* For purposes of this paragraph (e), in measuring the amount of work of an individual performing particular services, the work performed is determined based on the individual's hours of service (as defined under section 410(a)(3)(C)), except that a plan may use a different measure of work if appropriate under the facts and circumstances. For example, a plan may provide for a university professor's work to be measured by the number of courses taught during an annual work period in any case in which that individual's work assignment is generally based on a specified number of courses to be taught.

(7) *Most recent one-year period of service.* For purposes of paragraph (d) of this section, in the case of a part-time employee or a full-time employee who is employed for only part of the year determined on the basis of the employer's annual work period, the employee's most recent periods of service are aggregated to determine his or her most recent one-year period of service. In such a case, there is first taken into account his or her service during the annual work period for which the last year of service's includible compensation is being determined; then there is taken into account his or her service during his or her next preceding annual work period based on whole months; and so forth, until the employee's service equals, in the aggregate, one year of service.

(8) *Less than one year of service considered as one year.* If, at the close of a

taxable year, an employee has, after application of all of the other rules in this paragraph (e), some portion of one year of service (but has accumulated less than one year of service), the employee is deemed to have one year of service. Except as provided in the previous sentence, fractional years of service are not rounded up.

(9) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. (i) *Facts.* Individual G is employed half-time in 2004 and 2005 as a clerk by H, a hospital which is a section 501(c)(3) organization. G earns $20,000 from H in each of those years, and retires on December 31, 2005.

(ii) *Conclusion.* For purposes of determining G's includible compensation during G's last year of service under paragraph (d) of this section, G's most recent periods of service are aggregated to determine G's most recent one-year period of service. In this case, since D worked half-time in 2004 and 2005, the compensation D earned in those two years are aggregated to produce D's includible compensation for D's last full year in service. Thus, in this case, the $20,000 that D earned in 2004 and 2005 for D's half-time work are aggregated, so that D has $40,000 of includible compensation for D's most recent one-year of service for purposes of applying paragraphs (b)(2), (c)(3), and (d) of this section.

Example 2. (i) *Facts.* Individual H is employed as a part-time professor by public University U during the first semester of its two-semester 2004-2005 academic year. While H teaches one course generally for 3 hours a week during the first semester of the academic year, U's full-time faculty members generally teach for 9 hours a week during the full academic year.

(ii) *Conclusion.* For purposes of calculating how much of a year of service H performs in the 2004-2005 academic year (before application of the special rules of paragraphs (e)(7) and (8) of this section concerning less than one year of service), paragraph (e)(5)(iv) of this section is applied as follows: since H teaches one course at U for 3 hours per week for 1 semester and other faculty members at U teach 9 hours per week for 2 semesters, H is considered to have completed 3/18 or 1/6 of a year of service during the 2004-2005 academic year, determined as follows:

(A) The fractional year of service if H were a part-time employee for a full year is 3/9 (number of hours employed divided by the usual number of hours of work required for that position).

(B) The fractional year of service if H were a full-time employee for half of a year is 1/2 (one semester, divided by the usual 2-semester annual work period).

(C) These fractions are multiplied to obtain the fractional year of service: 3/9 times 1/2, or 3/18, equals 1/6 of a year of service.

(f) *Excess contributions or deferrals*—(1) *Inclusion in gross income.* Any contribution made for a participant to a section 403(b) contract for the taxable year that exceeds either the maximum annual contribution limit set forth in paragraph (b) of this section or the maximum annual section 403(b) elective deferral limit set forth in paragraph (c) of this section constitutes an excess contribution that is included in gross income for that taxable year. See §1.403(b)–3(d)(1)(iii) and (2)(i) for additional rules, including special rules relating to contracts that fail to be nonforfeitable. See also section 4973 for an excise tax applicable with respect to excess contributions to a custodial account and section 4979(f)(2)(B) for a special rule applicable if excess matching contributions, excess after-tax employee contributions, and excess section 403(b) elective deferrals do not exceed $100.

(2) *Separate account required for certain excess contributions; distribution of excess elective deferrals.* A contract to which a contribution is made that exceeds the maximum annual contribution limit set forth in paragraph (b) of this section is not a section 403(b) contract unless the excess contribution is held in a separate account which constitutes a separate account for purposes of section 72. See also §1.403(b)–3(a)(4) and paragraph (f)(4) of this section for additional rules with respect to the requirements of section 401(a)(30) and any excess deferral.

(3) *Ability to distribute excess contributions.* A contract does not fail to satisfy the requirements of §1.403(b)–3, the distribution rules of §1.403(b)–6 or 1.403(b)–9, or the funding rules of §1.403(b)–8 solely by reason of a distribution made from a separate account under paragraph (f)(2) of this section or made under paragraph (f)(4) of this section.

(4) *Excess section 403(b) elective deferrals.* A section 403(b) contract may provide that any excess deferral as a result of a failure to comply with the limitation under paragraph (c) of this section for a taxable year with respect to any section 403(b) elective deferral made for a participant by the employer will be distributed to the participant, with allocable net income, no later than April 15 of the following taxable year or otherwise in accordance with section 402(g). See section 402(g)(2)(A) for rules permitting the participant to allocate excess deferrals among the plans in which the participant has made elective deferrals, and see section 402(g)(2)(C) for special rules to determine the tax treatment of such a distribution.

(5) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. (i) *Facts.* Individual D's employer makes a $46,000 contribution for 2006 to an individual annuity insurance policy for Individual D that would otherwise be a section 403(b) contract. The contribution does not include any elective deferrals and the applicable limit under section 415(c) is $44,000 for 2006. The $2,000 section 415(c) excess is put into a separate account under the policy. Employer includes $2,000 in D's gross income as wages for 2006 and, to the extent of the amount held in the separate account for the section 415(c) excess contribution, does not treat the account as a contract to which section 403(b) applies.

(ii) *Conclusion.* The separate account for the section 415(c) excess contribution is a contract to which section 403(c) applies, but the excess contribution does not cause the rest of the contract to fail section 403(b).

Example 2. (i) *Facts.* Same facts as *Example 1*, except that the contribution is made to purchase mutual funds that are held in a custodial account, instead of an individual annuity insurance policy.

(ii) *Conclusion.* The conclusion is the same as in *Example 1*, except that the purchase constitutes a transfer described in section 83.

Example 3. (i) *Facts.* Same facts as *Example 1*, except that the amount held in the separate account for the section 415(c) excess contribution is subsequently distributed to D.

(ii) *Conclusion.* The distribution is included in gross income to the extent provided under section 72 relating to distributions from a section 403(c) contract.

Example 4. (i) *Facts.* Individual E makes section 403(b) elective deferrals totaling $15,500 for 2006, when E is age 45 and the applicable limit on section 403(b) elective deferrals is $15,000. On April 14, 2007, the plan refunds the $500 excess along with applicable earnings of $65.

(ii) *Conclusion.* The $565 payment constitutes a distribution of an excess deferral under paragraph (f)(4) of this section. Under section 402(g), the $500 excess deferral is included in E's gross income for 2006. The additional $65 is included in E's gross income for 2007 and, because the distribution is made by April 15, 2007 (as provided in section 402(g)(2)), the $65 is not subject to the additional 10 percent income tax on early distributions under section 72(t).

§1.403(b)–5 Nondiscrimination rules.

(a) *Nondiscrimination rules for contributions other than section 403(b) elective deferrals*—(1) *General rule.* Under section 403(b)(12)(A)(i), employer contributions and after-tax employee contributions to a section 403(b) plan must satisfy all of the following requirements (the nondiscrimination requirements) in the same manner as a qualified plan under section 401(a):

(i) Section 401(a)(4) (relating to nondiscrimination in contributions and

benefits), taking section 401(a)(5) into account.

(ii) Section 401(a)(17) (limiting the amount of compensation that can be taken into account).

(iii) Section 401(m) (relating to matching and after-tax employee contributions).

(iv) Section 410(b) (relating to minimum coverage).

(2) *Nonapplication to section 403(b) elective deferrals*. The requirements of this paragraph (a) do not apply to section 403(b) elective deferrals.

(3) *Compensation for testing*. Except as may otherwise be specifically permitted under the provisions referenced in paragraph (a)(1) of this section, compliance with those provisions is tested using compensation as defined in section 414(s) (and without regard to section 415(c)(3)(E)). In addition, for purposes of paragraph (a)(1) of this section, there may be excluded employees who are permitted to be excluded under paragraph (b)(4)(ii)(D) and (E) of this section. However, as provided in paragraph (b)(4)(i) of this section, the exclusion of any employee listed in paragraph (b)(4)(ii)(D) or (E) of this section is subject to the conditions applicable under section 410(b)(4).

(4) *Employer aggregation rules*. See regulations under section 414(b), (c), (m), and (o) for rules treating entities as a single employer for purposes of the nondiscrimination requirements.

(5) *Special rules for governmental plans*. Paragraphs (a)(1)(i), (iii), and (iv) of this section do not apply to a governmental plan as defined in section 414(d) (but contributions to a governmental plan must comply with paragraphs (a)(1)(ii) and (b) of this section).

(b) *Universal availability required for section 403(b) elective deferrals*—(1) *General rule*. Under section 403(b)(12)(A)(ii), all employees of the eligible employer must be permitted to have section 403(b) elective deferrals contributed on their behalf if any employee of the eligible employer may elect to have the organization make section 403(b) elective deferrals. Further, the employee's right to make elective deferrals also includes the right to designate section 403(b) elective deferrals as designated Roth contributions.

(2) *Effective opportunity required*. For purposes of paragraph (b)(1) of this section, an employee is not treated as being permitted to have section 403(b) elective deferrals contributed on the employee's behalf unless the employee is provided an effective opportunity that satisfies the requirements of this paragraph (b)(2). Whether an employee has an effective opportunity is determined based on all the relevant facts and circumstances, including notice of the availability of the election, the period of time during which an election may be made, and any other conditions on elections. A section 403(b) plan satisfies the effective opportunity requirement of this paragraph (b)(2) only if, at least once during each plan year, the plan provides an employee with an effective opportunity to make (or change) a cash or deferred election (as defined at §1.401(k)–1(a)(3)) between cash or a contribution to the plan. Further, an effective opportunity includes the right to have section 403(b) elective deferrals made on his or her behalf up to the lesser of the applicable limits in §1.403(b)–4(c) (including any permissible catch-up elective deferrals under §1.403(b)–4(c)(2) and (3)) or the applicable limits under the contract with the largest limitation, and applies to part-time employees as well as full-time employees. An effective opportunity is not considered to exist if there are any other rights or benefits (other than rights or benefits listed in §1.401(k)–1(e)(6)(i)(A), (B), or (D)) that are conditioned (directly or indirectly) upon a participant making or failing to make a cash or deferred election with respect to a contribution to a section 403(b) contract.

(3) *Special rules*. (i) In the case of a section 403(b) plan that covers the employees of more than one section 501(c)(3) organization, the universal availability requirement of this paragraph (b) applies separately to each common law entity (that is, applies separately to each section 501(c)(3) organization). In the case of a section 403(b) plan that covers the employees of more than one State entity, this requirement applies separately to each entity that is not part of a common payroll. An eligible employer may condition the employee's right to have section 403(b) elective deferrals made on his or her behalf on the employee electing a section 403(b) elective deferral of more than $200 for a year.

(ii) For purposes of this paragraph (b)(3), an employer that historically has treated one or more of its various geographically distinct units as separate for employee benefit purposes may treat each unit as a separate organization if the unit is operated independently on a day-to-day basis. Units are not geographically distinct if such units are located within the same Standard Metropolitan Statistical Area (SMSA).

(4) *Exclusions*—(i) *Exclusions for special types of employees*. A plan does not fail to satisfy the universal availability requirement of this paragraph (b) merely because it excludes one or more of the types of employees listed in paragraph (b)(4)(ii) of this section. However, the exclusion of any employee listed in paragraph (b)(4)(ii)(D) or (E) of this section is subject to the conditions applicable under section 410(b)(4). Thus, if any employee listed in paragraph (b)(4)(ii)(D) of this section has the right to have section 403(b) elective deferrals made on his or her behalf, then no employee listed in that paragraph (b)(4)(ii)(D) of this section may be excluded under this paragraph (b)(4) and, if any employee listed in paragraph (b)(4)(ii)(E) of this section has the right to have section 403(b) elective deferrals made on his or her behalf, then no employee listed in that paragraph (b)(4)(ii)(E) of this section may be excluded under this paragraph (b)(4).

(ii) *List of special types of excludible employees*. The following types of employees are listed in this paragraph (b)(4)(ii):

(A) Employees who are eligible under another section 403(b) plan, or a section 457(b) eligible governmental plan, of the employer which permits an amount to be contributed or deferred at the election of the employee.

(B) Employees who are eligible to make a cash or deferred election (as defined at §1.401(k)–1(a)(3)) under a section 401(k) plan of the employer.

(C) Employees who are non-resident aliens described in section 410(b)(3)(C).

(D) Subject to the conditions applicable under section 410(b)(4) (including section 410(b)(4)(B) permitting separate testing for employees not meeting minimum age and service requirements), employees who are students performing services described in section 3121(b)(10).

(E) Subject to the conditions applicable under section 410(b)(4), employees who

normally work fewer than 20 hours per week (or such lower number of hours per week as may be set forth in the plan).

(iii) *Special rules.* (A) A section 403(b) plan is permitted to take into account coverage under another plan, as permitted in paragraphs (b)(4)(ii)(A) and (B) of this section, only if the rights to make elective deferrals with respect to that coverage would satisfy paragraphs (b)(2) and (4)(i) of this section if that coverage were provided under the section 403(b) plan.

(B) For purposes of paragraph (b)(4)(ii)(E) of this section, an employee normally works fewer than 20 hours per week if and only if—

(*1*) For the 12-month period beginning on the date the employee's employment commenced, the employer reasonably expects the employee to work fewer than 1,000 hours of service (as defined in section 410(a)(3)(C)) in such period; and

(*2*) For each plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced (or, if the plan so provides, each subsequent 12-month period), the employee worked fewer than 1,000 hours of service in the preceding 12-month period. (See, however, section 202(a)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 829) Public Law 93–406, and regulations under section 410(a) of the Internal Revenue Code applicable with respect to plans that are subject to Title I of ERISA.)

(c) *Plan required.* Contributions to an annuity contract do not satisfy the requirements of this section unless the contributions are made pursuant to a plan, as defined in §1.403(b)–3(b)(3), and the terms of the plan satisfy this section.

(d) *Church plans exception.* This section does not apply to a section 403(b) contract purchased by a church (as defined in §1.403(b)–2).

(e) *Other rules.* This section only reflects requirements of the Internal Revenue Code applicable for purposes of section 403(b) and does not include other requirements. Specifically, this section does not reflect the requirements of ERISA that may apply with respect to section 403(b) arrangements, such as the vesting requirements at 29 U.S.C. 1053.

§1.403(b)–6 Timing of distributions and benefits.

(a) *Distributions generally.* This section provides special rules regarding the timing of distributions from, and the benefits that may be provided under, a section 403(b) contract, including limitations on when early distributions can be made (in paragraphs (b) through (d) of this section), required minimum distributions (in paragraph (e) of this section), and special rules relating to loans (in paragraph (f) of this section) and incidental benefits (in paragraph (g) of this section).

(b) *Distributions from contracts other than custodial accounts or amounts attributable to section 403(b) elective deferrals.* Except as provided in paragraph (c) of this section relating to distributions from custodial accounts, paragraph (d) of this section relating to distributions attributable to section 403(b) elective deferrals, §1.403(b)–4(f) (relating to correction of excess deferrals), or §1.403(b)–10(a) (relating to plan termination), a section 403(b) contract is permitted to distribute retirement benefits to the participant no earlier than upon the earlier of the participant's severance from employment or upon the prior occurrence of some event, such as after a fixed number of years, the attainment of a stated age, or disability. See §1.401–1(b)(1)(ii) for additional guidance. This paragraph (b) does not apply to after-tax employee contributions or earnings thereon.

(c) *Distributions from custodial accounts that are not attributable to section 403(b) elective deferrals.* Except as provided in §1.403(b)–4(f) (relating to correction of excess deferrals) or §1.403(b)–10(a) (relating to plan termination), distributions from a custodial account, as defined in §1.403(b)–8(d)(2), may not be paid to a participant before the participant has a severance from employment, dies, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½. Any amounts transferred out of a custodial account to an annuity contract or retirement income account, including earnings thereon, continue to be subject to this paragraph (c). This paragraph (c) does not apply to distributions that are attributable to section 403(b) elective deferrals.

(d) *Distribution of section 403(b) elective deferrals*—(*1*) *Limitation on distributions*—(i) *General rule.* Except as provided in §1.403(b)–4(f) (relating to correction of excess deferrals) or §1.403(b)–10(a) (relating to plan termination), distributions of amounts attributable to section 403(b) elective deferrals may not be paid to a participant earlier than the earliest of the date on which the participant has a severance from employment, dies, has a hardship, becomes disabled (within the meaning of section 72(m)(7)), or attains age 59½.

(ii) *Special rule for pre-1989 section 403(b) elective deferrals.* For special rules relating to amounts held as of the close of the taxable year beginning before January 1, 1989 (which does not apply to earnings thereon), see section 1123(e)(3) of the Tax Reform Act of 1986 (100 Stat. 2085, 2475) Public Law 99–514, and section 1011A(c)(11) of the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3342, 3476) Public Law 100–647.

(*2*) *Hardship rules.* A hardship distribution under this paragraph (d) has the same meaning as a distribution on account of hardship under §1.401(k)–1(d)(3) and is subject to the rules and restrictions set forth in §1.401(k)–1(d)(3) (including limiting the amount of a distribution in the case of hardship to the amount necessary to satisfy the hardship). In addition, a hardship distribution is limited to the aggregate dollar amount of the participant's section 403(b) elective deferrals under the contract (and may not include any income thereon), reduced by the aggregate dollar amount of the distributions previously made to the participant from the contract.

(*3*) *Failure to keep separate accounts.* If a section 403(b) contract includes both section 403(b) elective deferrals and other contributions and the section 403(b) elective deferrals are not maintained in a separate account, then distributions may not be made earlier than the later of—

(i) Any date permitted under paragraph (d)(1) of this section; and

(ii) Any date permitted under paragraph (b) or (c) of this section with respect to contributions that are not section 403(b) elective deferrals (whichever applies to the contributions that are not section 403(b) elective deferrals).

(e) *Minimum required distributions for eligible plans*—(*1*) *In general.* Under section 403(b)(10), a section 403(b) contract must meet the minimum distribution re-

quirements of section 401(a)(9) (in both form and operation). See section 401(a)(9) for these requirements.

(2) *Treatment as IRAs.* For purposes of applying the distribution rules of section 401(a)(9) to section 403(b) contracts, the minimum distribution rules applicable to individual retirement annuities described in section 408(b) and individual retirement accounts described in section 408(a) apply to section 403(b) contracts. Consequently, except as otherwise provided in paragraphs (e)(3) through (e)(5) of this section, the distribution rules in section 401(a)(9) are applied to section 403(b) contracts in accordance with the provisions in §1.408–8 for purposes of determining required minimum distributions.

(3) *Required beginning date.* The required beginning date for purposes of section 403(b)(10) is April 1 of the calendar year following the later of the calendar year in which the employee attains age 70½ or the calendar year in which the employee retires from employment with the employer maintaining the plan. However, for any section 403(b) contract that is not part of a governmental plan or church plan, the required beginning date for a 5-percent owner is April 1 of the calendar year following the calendar year in which the employee attains age 70½.

(4) *Surviving spouse rule does not apply.* The special rule in §1.408–8, A–5 (relating to spousal beneficiaries), does not apply to a section 403(b) contract. Thus, the surviving spouse of a participant is not permitted to treat a section 403(b) contract as the spouse's own section 403(b) contract, even if the spouse is the sole beneficiary.

(5) *Retirement income accounts.* For purposes of §1.401(a)(9)–6, A–4 (relating to annuity contracts), annuity payments provided with respect to retirement income accounts do not fail to satisfy the requirements of section 401(a)(9) merely because the payments are not made under an annuity contract purchased from an insurance company, provided that the relationship between the annuity payments and the retirement income accounts is not inconsistent with any rules prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter). See also §1.403(b)–9(a)(5) for additional rules relating to annuities payable from a retirement income account).

(6) *Special rules for benefits accruing before December 31, 1986.* (i) The distribution rules provided in section 401(a)(9) do not apply to the undistributed portion of the account balance under the section 403(b) contract valued as of December 31, 1986, exclusive of subsequent earnings (pre-'87 account balance). The distribution rules provided in section 401(a)(9) apply to all benefits under section 403(b) contracts accruing after December 31, 1986 (post-'86 account balance), including earnings after December 31, 1986. Consequently, the post-'86 account balance includes earnings after December 31, 1986, on contributions made before January 1, 1987, in addition to the contributions made after December 31, 1986, and earnings thereon.

(ii) The issuer or custodian of the section 403(b) contract must keep records that enable it to identify the pre-'87 account balance and subsequent changes as set forth in paragraph (d)(6)(iii) of this section and provide such information upon request to the relevant employee or beneficiaries with respect to the contract. If the issuer or custodian does not keep such records, the entire account balance is treated as subject to section 401(a)(9).

(iii) In applying the distribution rules in section 401(a)(9), only the post-'86 account balance is used to calculate the required minimum distribution for a calendar year. The amount of any distribution from a contract is treated as being paid from the post-'86 account balance to the extent the distribution is required to satisfy the minimum distribution requirement with respect to that contract for a calendar year. Any amount distributed in a calendar year from a contract in excess of the required minimum distribution for a calendar year with respect to that contract is treated as paid from the pre-'87 account balance, if any, of that contract.

(iv) If an amount is distributed from the pre-'87 account balance and rolled over to another section 403(b) contract, the amount is treated as part of the post-'86 account balance in that second contract. However, if the pre-'87 account balance under a section 403(b) contract is directly transferred to another section 403(b) contract (as permitted under §1.403(b)–10(b)), the amount transferred retains its character as a pre-'87 account balance, provided the issuer of the transferee contract satisfies the recordkeeping requirements of paragraph (e)(6)(ii) of this section.

(v) The distinction between the pre-'87 account balance and the post-'86 account balance provided for under this paragraph (e)(6) of this section has no relevance for purposes of determining the portion of a distribution that is includible in income under section 72.

(vi) The pre-'87 account balance must be distributed in accordance with the incidental benefit requirement of §1.401–1(b)(1)(i). Distributions attributable to the pre-'87 account balance are treated as satisfying this requirement if all distributions from the section 403(b) contract (including distributions attributable to the post-'86 account balance) satisfy the requirements of §1.401–1(b)(1)(i) without regard to this section, and distributions attributable to the post-'86 account balance satisfy the rules of this paragraph (e) (without regard to this paragraph (e)(6)). Distributions attributable to the pre-'87 account balance are treated as satisfying the incidental benefit requirement if all distributions from the section 403(b) contract (including distributions attributable to both the pre-'87 account balance and the post-'86 account balance) satisfy the rules of this paragraph (e) (without regard to this paragraph (e)(6)).

(7) *Application to multiple contracts for an employee.* The required minimum distribution must be separately determined for each section 403(b) contract of an employee. However, because, as provided in paragraph (e)(2) of this section, the distribution rules in section 401(a)(9) apply to section 403(b) contracts in accordance with the provisions in §1.408–8, the required minimum distribution from one section 403(b) contract of an employee is permitted to be distributed from another section 403(b) contract in order to satisfy section 401(a)(9). Thus, as provided in §1.408–8, A–9, with respect to IRAs, the required minimum distribution amount from each contract is then totaled and the total minimum distribution taken from any one or more of the individual section 403(b) contracts. However, consistent with the rules in §1.408–8, A–9, only amounts in section 403(b) contracts

that an individual holds as an employee may be aggregated. Amounts in section 403(b) contracts that an individual holds as a beneficiary of the same decedent may be aggregated, but such amounts may not be aggregated with amounts held in section 403(b) contracts that the individual holds as the employee or as the beneficiary of another decedent. Distributions from section 403(b) contracts do not satisfy the minimum distribution requirements for IRAs, nor do distributions from IRAs satisfy the minimum distribution requirements for section 403(b) contracts.

(f) *Loans.* The determination of whether the availability of a loan, the making of a loan, or a failure to repay a loan made from an issuer of a section 403(b) contract to a participant or beneficiary is treated as a distribution (directly or indirectly) for purposes of this section, and the determination of whether the availability of the loan, the making of the loan, or a failure to repay the loan is in any other respect a violation of the requirements of section 403(b) and §§1.403(b)–1 through 1.403(b)–5, this section and §§1.403(b)–7 through 1.403(b)–11 depends on the facts and circumstances. Among the facts and circumstances are whether the loan has a fixed repayment schedule and bears a reasonable rate of interest, and whether there are repayment safeguards to which a prudent lender would adhere. Thus, for example, a loan must bear a reasonable rate of interest in order to be treated as not being a distribution. However, a plan loan offset is a distribution for purposes of this section. See §1.72(p)–1, Q&A–13. See also §1.403(b)–7(d) relating to the application of section 72(p) with respect to the taxation of a loan made under a section 403(b) contract. (Further, see section 408(b)(1) of Title I of ERISA and 29 CFR 2550.408b–1 of the Department of Labor regulations concerning additional requirements applicable with respect to plans that are subject to Title I of ERISA.)

(g) *Death benefits and other incidental benefits.* An annuity is not a section 403(b) contract if it fails to satisfy the incidental benefit requirement of §1.401–1(b)(1)(ii) (in form or in operation). For purposes of this paragraph (g), to the extent the incidental benefit requirement of §1.401–1(b)(1)(ii) requires a distribution of the participant's or beneficiary's accumulated benefit, that requirement is deemed to be satisfied if distributions satisfy the minimum distribution requirements of section 401(a)(9). In addition, if a contract issued by an insurance company qualified to issue annuities in a State includes provisions under which, in the event a participant becomes disabled, benefits will be provided by the insurance carrier as if employer contributions were continued until benefit distribution commences, then that benefit is treated as an incidental benefit (as insurance for a deferred annuity benefit in the event of disability) that must satisfy the incidental benefit requirement of §1.401–1(b)(1)(ii) (taking into account any other incidental benefits provided under the plan).

(h) *Special rule regarding severance from employment.* For purposes of this section, severance from employment occurs on any date on which an employee ceases to be an employee of an eligible employer, even though the employee may continue to be employed either by another entity that is treated as the same employer where either that other entity is not an entity that can be an eligible employer (such as transferring from a section 501(c)(3) organization to a for-profit subsidiary of the section 501(c)(3) organization) or in a capacity that is not employment with an eligible employer (for example, ceasing to be an employee performing services for a public school but continuing to work for the same State employer). Thus, this paragraph (h) does not apply if an employee transfers from one section 501(c)(3) organization to another section 501(c)(3) organization that is treated as the same employer or if an employee transfers from one public school to another public school of the same State employer.

(i) *Certain limitations do not apply to rollover contributions.* The limitations on distributions in paragraphs (b) through (d) of this section do not apply to amounts held in a separate account for eligible rollover distributions as described in §1.403(b)–10(d).

§1.403(b)–7 Taxation of distributions and benefits.

(a) *General rules for when amounts are included in gross income.* Except as provided in this section (or in §1.403(b)–10(c) relating to payments pursuant to a qualified domestic relations order), amounts actually distributed from a section 403(b) contract are includible in the gross income of the recipient participant or beneficiary (in the year in which so distributed) under section 72 (relating to annuities). For an additional income tax that may apply to certain early distributions that are includible in gross income, see section 72(t).

(b) *Rollovers to individual retirement arrangements and other eligible retirement plans*—(1) *Timing of taxation of rollovers.* In accordance with sections 402(c), 403(b)(8), and 403(b)(10), a direct rollover in accordance with section 401(a)(31) is not includible in the gross income of a participant or beneficiary in the year rolled over. In addition, any payment made in the form of an eligible rollover distribution (as defined in section 402(c)(4)) is not includible in gross income in the year paid to the extent the payment is contributed to an eligible retirement plan (as defined in section 402(c)(8)(B)) within 60 days, including the contribution to the eligible retirement plan of any property distributed. For this purpose, the rules of section 402(c)(2) through (7) and (c)(9) apply. Thus, to the extent that a portion of a distribution (including a distribution from a designated Roth account) would be excluded from gross income if it were not rolled over, if that portion of the distribution is to be rolled over into an eligible retirement plan that is not an IRA, the rollover must be accomplished through a direct rollover of the entire distribution to a plan qualified under section 401(a) or section 403(b) plan and that plan must agree to separately account for the amount not includible in income (so that a 60-day rollover to a plan qualified under section 401(a) or another section 403(b) plan is not available for this portion of the distribution). Any direct rollover under this paragraph (b)(1) is a distribution that is subject to the distribution requirements of §1.403(b)–6.

(2) *Requirement that contract provide rollover options for eligible rollover distributions.* As required in §1.403(b)–3(a)(7), an annuity contract is not a section 403(b) contract unless the contract provides that if the distributee of an eligible rollover distribution elects to have the distribution paid directly to an eligible retirement plan (as defined in section 402(c)(8)(B)) and specifies the eligible retirement plan to which the distribution is to be paid, then the dis-

tribution will be paid to that eligible retirement plan in a direct rollover. For purposes of determining whether a contract satisfies this requirement, the provisions of section 401(a)(31) apply to the annuity as though it were a plan qualified under section 401(a) unless otherwise provided in section 401(a)(31). Thus, the special rule in §1.401(k)–1(f)(3)(ii) with respect to distributions from a designated Roth account that are expected to total less than $200 during a year applies to designated Roth accounts under a section 403(b) plan. In applying the provisions of this paragraph (b)(2), the payor of the eligible rollover distribution from the contract is treated as the plan administrator.

(3) *Requirement that contract payor provide notice of rollover option to distributees.* To ensure that the distributee of an eligible rollover distribution from a section 403(b) contract has a meaningful right to elect a direct rollover, section 402(f) requires that the distributee be informed of the option. Thus, within a reasonable time period before making the initial eligible rollover distribution, the payor must provide an explanation to the distributee of his or her right to elect a direct rollover and the income tax withholding consequences of not electing a direct rollover. For purposes of satisfying the reasonable time period requirement, the plan timing rule provided in section 402(f)(1) and §1.402(f)–1 applies to section 403(b) contracts.

(4) *Mandatory withholding upon certain eligible rollover distributions from contracts.* If a distributee of an eligible rollover distribution from a section 403(b) contract does not elect to have the eligible rollover distribution paid directly to an eligible retirement plan in a direct rollover, the eligible rollover distribution is subject to 20-percent income tax withholding imposed under section 3405(c). See section 3405(c) and §31.3405(c)–1 of this chapter for provisions regarding the withholding requirements relating to eligible rollover distributions.

(5) *Automatic rollover for certain mandatory distributions under section 401(a)(31).* In accordance with section 403(b)(10), a section 403(b) plan is required to comply with section 401(a)(31) (including automatic rollover for certain mandatory distributions) in the same manner as a qualified plan.

(c) *Special rules.* See section 402(g)(2)(C) for special rules to determine the tax treatment of a distribution of excess deferrals, and see §1.401(m)–1(e)(3)(v) for the tax treatment of corrective distributions of after-tax employee contributions and matching contributions to comply with section 401(m). See sections 402(l) and 403(b)(2) for a special rule regarding distributions for certain retired public safety officers made from a governmental plan for the direct payment of certain premiums.

(d) *Amounts taxable under section 72(p)(1).* In accordance with section 72(p), the amount of any loan from a section 403(b) contract to a participant or beneficiary (including any pledge or assignment treated as a loan under section 72(p)(1)(B)) is treated as having been received as a distribution from the contract under section 72(p)(1), except to the extent set forth in section 72(p)(2) (relating to loans that do not exceed a maximum amount and that are repayable in accordance with certain terms) and §1.72(p)–1. See generally §1.72(p)–1. Thus, except to the extent a loan satisfies section 72(p)(2), any amount loaned from a section 403(b) contract to a participant or beneficiary (including any pledge or assignment treated as a loan under section 72(p)(1)(B)) is includible in the gross income of the participant or beneficiary for the taxable year in which the loan is made. A deemed distribution is not an actual distribution for purposes of §1.403(b)–6, as provided at §1.72(p)–1, Q&A–12 and Q&A–13. (Further, see section 408(b)(1) of Title I of ERISA concerning the effect of noncompliance with Title I loan requirements for plans that are subject to Title I of ERISA.)

(e) *Special rules relating to distributions from a designated Roth account.* If an amount is distributed from a designated Roth account under a section 403(b) plan, the amount, if any, that is includible in gross income and the amount, if any, that may be rolled over to another section 403(b) plan is determined under §1.402A–1. Thus, the designated Roth account is treated as a separate contract for purposes of section 72. For example, the rules of section 72(b) must be applied separately to annuity payments with respect to a designated Roth account under a section 403(b) plan and separately to annuity payments with respect to amounts attributable to any other contributions to the section 403(b) plan.

(f) *Aggregation of contracts.* In accordance with section 403(b)(5), the rules of this section are applied as if all annuity contracts for the employee by the employer are treated as a single contract.

(g) *Certain rules relating to employment taxes.* With respect to contributions under the Federal Insurance Contributions Act (FICA) under Chapter 21, see section 3121(a)(5)(D) for a special rule relating to section 403(b) contracts. With respect to income tax withholding on distributions from section 403(b) contracts, see section 3405 generally. However, see section 3401 for income tax withholding applicable to annuity contracts or custodial accounts that are not section 403(b) contracts or for cases in which an annuity contract or custodial account ceases to be a section 403(b) contract. See also §1.72(p)–1, Q&A–15, and §35.3405(c)–1, Q&A–11 of this chapter, for special rules relating to income tax withholding for loans made from certain employer plans, including section 403(b) contracts.

§1.403(b)–8 Funding.

(a) *Investments.* Section 403(b) and §1.403(b)–3(a) only apply to amounts held in an annuity contract (as defined in §1.403(b)–2), including a custodial account that is treated as an annuity contract under paragraph (d) of this section, or a retirement income account that is treated as an annuity contract under §1.403(b)–9.

(b) *Contributions to the plan.* Contributions to a section 403(b) plan must be transferred to the insurance company issuing the annuity contract (or the entity holding assets of any custodial or retirement income account that is treated as an annuity contract) within a period that is not longer than is reasonable for the proper administration of the plan. For purposes of this requirement, the plan may provide for section 403(b) elective deferrals for a participant under the plan to be transferred to the annuity contract within a specified period after the date the amounts would otherwise have been paid to the participant. For example, the plan could provide for section 403(b) elective deferrals under the plan to be contributed within 15 business days following the month in which these amounts

would otherwise have been paid to the participant.

(c) *Annuity contracts*—(1) *Generally.* As defined in §1.403(b)–2, and except as otherwise permitted under this section, an annuity contract means a contract that is issued by an insurance company qualified to issue annuities in a State and that includes payment in the form of an annuity. This paragraph (c) sets forth additional rules regarding annuity contracts.

(2) *Certain insurance contracts.* Neither a life insurance contract, as defined in section 7702, an endowment contract, a health or accident insurance contract, nor a property, casualty, or liability insurance contract meets the definition of an annuity contract. See §1.401(f)–4(e). If a contract issued by an insurance company qualified to issue annuities in a State provides death benefits as part of the contract, then that coverage is permitted, assuming that those death benefits do not cause the contract to fail to satisfy any requirement applicable to section 403(b) contracts, for example, assuming that those benefits satisfy the incidental benefit requirement of §1.401–1(b)(1)(i), as required by §1.403(b)–6(g).

(3) *Special rule for certain contracts.* This paragraph (c)(3) applies in the case of a contract issued under a State section 403(b) plan established on or before May 17, 1982, or for an employee who becomes covered for the first time under the plan after May 17, 1982, unless the Commissioner had before that date issued any written communication (either to the employer or financial institution) to the effect that the arrangement under which the contract was issued did not meet the requirements of section 403(b). The requirement that the contract be issued by an insurance company qualified to issue annuities in a State does not apply to a contract described in the preceding sentence if one of the following two conditions is satisfied and that condition has been satisfied continuously since May 17, 1982—

(i) Benefits under the contract are provided from a separately funded retirement reserve that is subject to supervision of the State insurance department; or

(ii) Benefits under the contract are provided from a fund that is separate from the fund used to provide statutory benefits payable under a state retirement system and that is part of a State teachers retirement system (including a state university retirement system) to purchase benefits that are unrelated to the basic benefits provided under the retirement system, and the death benefit provided under the contract does not at any time exceed the larger of the reserve or the contribution made for the employee.

(d) *Custodial accounts*—(1) *Treatment as a section 403(b) contract.* Under section 403(b)(7), a custodial account is treated as an annuity contract for purposes of §§1.403(b)–1 through 1.403(b)–7, this section and §§1.403(b)–9 through 1.403(b)–11. See section 403(b)(7)(B) for special rules regarding the tax treatment of custodial accounts and section 4973(c) for an excise tax that applies to excess contributions to a custodial account.

(2) *Custodial account defined.* A custodial account means a plan, or a separate account under a plan, in which an amount attributable to section 403(b) contributions (or amounts rolled over to a section 403(b) contract, as described in §1.403(b)–10(d)) is held by a bank or a person who satisfies the conditions in section 401(f)(2), if—

(i) All of the amounts held in the account are invested in stock of a regulated investment company (as defined in section 851(a) relating to mutual funds);

(ii) The requirements of §1.403(b)–6(c) (imposing restrictions on distributions with respect to a custodial account) are satisfied with respect to the amounts held in the account;

(iii) The assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries (for which purpose, assets are treated as diverted to the employer if the employer borrows assets from the account); and

(iv) The account is not part of a retirement income account.

(3) *Effect of definition.* The requirement in paragraph (d)(2)(i) of this section is not satisfied if the account includes any assets other than stock of a regulated investment company.

(4) *Treatment of custodial account.* A custodial account is treated as a section 401 qualified plan solely for purposes of subchapter F of subtitle A and subtitle F of the Internal Revenue Code with respect to amounts received by it (and income from investment thereof). This treatment only applies to a custodial account that constitutes a section 403(b) contract under §§1.403(b)–1 through 1.403(b)–7, this section and §§1.403(b)–9 through 1.403(b)–11 or that would constitute a section 403(b) contract under §§1.403(b)–1 through 1.403(b)–7, this section and §§1.403(b)–9 through 1.403(b)–11 if the amounts held in the account were to satisfy the nonforfeitability requirement of §1.403(b)–3(a)(2).

(e) *Retirement income accounts.* See §1.403(b)–9 for special rules under which a retirement income account for employees of a church-related organization is treated as a section 403(b) contract for purposes of §§1.403(b)–1 through 1.403(b)–7, this section and §§1.403(b)–9 through 1.403(b)–11.

(f) *Combining assets.* To the extent permitted by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), trust assets held under a custodial account and trust assets held under a retirement income account, as described in §1.403(b)–9(a)(6), may be invested in a group trust with trust assets held under a qualified plan or individual retirement plan. For this purpose, a trust includes a custodial account that is treated as a trust under section 401(f).

§1.403(b)–9 Special rules for church plans.

(a) *Retirement income accounts*—(1) *Treatment as a section 403(b) contract.* Under section 403(b)(9), a retirement income account for employees of a church-related organization (as defined in §1.403(b)–2) is treated as an annuity contract for purposes of §§1.403(b)–1 through 1.403(b)–8, this section, §1.403(b)–10 and §1.403(b)–11.

(2) *Retirement income account defined*—(i) *In general.* A retirement income account means a defined contribution program established or maintained by a church-related organization under which—

(A) There is separate accounting for the retirement income account's interest in the underlying assets (namely, there must be sufficient separate accounting in order for it to be possible at all times to determine the retirement income account's interest in the underlying assets and to distinguish

that interest from any interest that is not part of the retirement income account);

(B) Investment performance is based on gains and losses on those assets; and

(C) The assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries (and for this purpose, assets are treated as diverted to the employer if there is a loan or other extension of credit from assets in the account to the employer).

(ii) *Plan required.* A retirement income account must be maintained pursuant to a program which is a plan (as defined in §1.403(b)–3(b)(3)) and the plan document must state (or otherwise evidence in a similarly clear manner) the intent to constitute a retirement income account.

(3) *Ownership or use constitutes distribution.* Any asset of a retirement income account that is owned or used by a participant or beneficiary is treated as having been distributed to that participant or beneficiary. See §§1.403(b)–6 and 1.403(b)–7 for rules relating to distributions.

(4) *Coordination of retirement income account with custodial account rules.* A retirement income account that is treated as an annuity contract is not a custodial account (as defined in §1.403(b)–8(d)(2)), even if it is invested solely in stock of a regulated investment company.

(5) *Life annuities.* A retirement income account may distribute benefits in a form that includes a life annuity only if—

(i) The amount of the distribution form has an actuarial present value, at the annuity starting date, equal to the participant's or beneficiary's accumulated benefit, based on reasonable actuarial assumptions, including regarding interest and mortality; and

(ii) The plan sponsor guarantees benefits in the event that a payment is due that exceeds the participant's or beneficiary's accumulated benefit.

(6) *Combining retirement income account assets with other assets.* For purposes of §1.403(b)–8(f) relating to combining assets, retirement income account assets held in trust (including a custodial account that is treated as a trust under section 401(f)) are subject to the same rules regarding combining of assets as custodial account assets. In addition, retirement income account assets are permitted to be commingled in a common fund with amounts devoted exclusively to church purposes (such as a fund from which unfunded pension payments are made to former employees of the church). However, unless otherwise permitted by the Commissioner, no assets of the plan sponsor, other than retirement income account assets, may be combined with custodial account assets or any other assets permitted to be combined under §1.403(b)–8(f). This paragraph (a)(6) is subject to any additional rules issued by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

(7) *Trust treated as tax exempt.* A trust (including a custodial account that is treated as a trust under section 401(f)) that includes no assets other than assets of a retirement income account is treated as an organization that is exempt from taxation under section 501(a).

(b) *No compensation limitation up to $10,000.* See section 415(c)(7) for special rules regarding certain annual additions not exceeding $10,000.

(c) *Special deduction rule for self-employed ministers.* See section 404(a)(10) for a special rule regarding the deductibility of a contribution made by a self-employed minister.

§1.403(b)–10 Miscellaneous provisions.

(a) *Plan terminations and frozen plans*—(1) *In general.* An employer is permitted to amend its section 403(b) plan to eliminate future contributions for existing participants or to limit participation to existing participants and employees (to the extent consistent with §1.403(b)–5). A section 403(b) plan is permitted to contain provisions that provide for plan termination and that allow accumulated benefits to be distributed on termination. However, in the case of a section 403(b) contract that is subject to the distribution restrictions in §1.403(b)–6(c) or (d) (relating to custodial accounts and section 403(b) elective deferrals), termination of the plan and the distribution of accumulated benefits is permitted only if the employer (taking into account all entities that are treated as the same employer under section 414(b), (c), (m), or (o) on the date of the termination) does not make contributions to any section 403(b) contract that is not part of the plan during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. However, if at all times during the period beginning 12 months before the termination and ending 12 months after distribution of all assets from the terminated plan, fewer than 2 percent of the employees who were eligible under the section 403(b) plan as of the date of plan termination are eligible under the alternative section 403(b) contract, the alternative section 403(b) contract is disregarded. To the extent a contract fails to satisfy the nonforfeitability requirement of §1.403(b)–3(a)(2) at the date of plan termination, the contact is not, and cannot later become, a section 403(b) contract. In order for a section 403(b) plan to be considered terminated, all accumulated benefits under the plan must be distributed to all participants and beneficiaries as soon as administratively practicable after termination of the plan. For this purpose, delivery of a fully paid individual insurance annuity contract is treated as a distribution. The mere provision for, and making of, distributions to participants or beneficiaries upon plan termination does not cause a contract to cease to be a section 403(b) contract. See §1.403(b)–7 for rules regarding the tax treatment of distributions, including §1.403(b)–7(b)(1) under which an eligible rollover distribution is not included in gross income if paid in a direct rollover to an eligible retirement plan or if transferred to an eligible retirement plan within 60 days.

(2) *Employers that cease to be eligible employers.* An employer that ceases to be an eligible employer may no longer contribute to a section 403(b) contract for any subsequent period, and the contract will fail to satisfy §1.403(b)–3(a) if any further contributions are made with respect to a period after the employer ceases to be an eligible employer.

(b) *Contract exchanges and plan-to-plan transfers*—(1) *Contract exchanges and transfers*—(i) *General rule.* If the conditions in paragraph (b)(2) of this section are met, a section 403(b) contract held under a section 403(b) plan is permitted to be exchanged for another section 403(b) contract held under that section 403(b) plan. Further, if the conditions in paragraph (b)(3) of this section are met, a section 403(b) plan is permitted

to provide for the transfer of its assets (including any assets held in a custodial account or retirement income account that are treated as section 403(b) contracts) to another section 403(b) plan. In addition, if the conditions in paragraph (b)(4) of this section (relating to permissive service credit and repayments under section 415) are met, a section 403(b) plan is permitted to provide for the transfer of its assets to a qualified plan under section 401(a). However, neither a qualified plan nor an eligible governmental plan under section 457(b) may transfer assets to a section 403(b) plan, and a section 403(b) plan may not accept such a transfer. In addition, a section 403(b) contract may not be exchanged for an annuity contract that is not a section 403(b) contract. Neither a plan-to-plan transfer nor a contract exchange permitted under this paragraph (b) is treated as a distribution for purposes of the distribution restrictions at §1.403(b)–6. Therefore, such a transfer or exchange may be made before severance from employment or another distribution event. Further, no amount is includible in gross income by reason of such a transfer or exchange.

(ii) *ERISA rules.* See §1.414(l)–1 for other rules that are applicable to section 403(b) plans that are subject to section 208 of the Employee Retirement Income Security Act of 1974 (88 Stat. 829, 865).

(2) *Requirements for contract exchange within the same plan*—(i) *General rule.* A section 403(b) contract of a participant or beneficiary may be exchanged under paragraph (b)(1) of this section for another section 403(b) contract of that participant or beneficiary under the same section 403(b) plan if each of the following conditions are met:

(A) The plan under which the contract is issued provides for the exchange.

(B) The participant or beneficiary has an accumulated benefit immediately after the exchange that is at least equal to the accumulated benefit of that participant or beneficiary immediately before the exchange (taking into account the accumulated benefit of that participant or beneficiary under both section 403(b) contracts immediately before the exchange).

(C) The other contract is subject to distribution restrictions with respect to the participant that are not less stringent than those imposed on the contract being exchanged, and the employer enters into an agreement with the issuer of the other contract under which the employer and the issuer will from time to time in the future provide each other with the following information:

(*1*) Information necessary for the resulting contract, or any other contract to which contributions have been made by the employer, to satisfy section 403(b), including information concerning the participant's employment and information that takes into account other section 403(b) contracts or qualified employer plans (such as whether a severance from employment has occurred for purposes of the distribution restrictions in §1.403(b)–6 and whether the hardship withdrawal rules of §1.403(b)–6(d)(2) are satisfied).

(*2*) Information necessary for the resulting contract, or any other contract to which contributions have been made by the employer, to satisfy other tax requirements (such as whether a plan loan satisfies the conditions in section 72(p)(2) so that the loan is not a deemed distribution under section 72(p)(1)).

(ii) *Accumulated benefit.* The condition in paragraph (b)(2)(i)(B) of this section is satisfied if the exchange would satisfy section 414(l)(1) if the exchange were a transfer of assets.

(iii) *Authority for future guidance.* Subject to such conditions as the Commissioner determines to be appropriate, the Commissioner may issue rules of general applicability, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), permitting an exchange of one section 403(b) contract for another section 403(b) contract for an exchange that does not satisfy paragraph (b)(2)(i)(C) of this section. Any such rules must require the resulting contract to set forth procedures that the Commissioner determines are reasonably designed to ensure compliance with those requirements of section 403(b) or other tax provisions that depend on either information concerning the participant's employment or information that takes into account other section 403(b) contracts or other employer plans (such as whether a severance from employment has occurred for purposes of the distribution restrictions in §1.403(b)–6, whether the hardship withdrawal rules of §1.403(b)–6(d)(2) are satisfied, and whether a plan loan constitutes a deemed distribution under section 72(p)).

(3) *Requirements for plan-to-plan transfers.* (i) A plan-to-plan transfer under paragraph (b)(1) of this section from a section 403(b) plan to another section 403(b) plan is permitted if each of the following conditions are met—

(A) In the case of a transfer for a participant, the participant is an employee or former employee of the employer (or the business of the employer) for the receiving plan.

(B) In the case of a transfer for a beneficiary of a deceased participant, the participant was an employee or former employee of the employer (or business of the employer) for the receiving plan.

(C) The transferor plan provides for transfers.

(D) The receiving plan provides for the receipt of transfers.

(E) The participant or beneficiary whose assets are being transferred has an accumulated benefit immediately after the transfer that is at least equal to the accumulated benefit of that participant or beneficiary immediately before the transfer.

(F) The receiving plan provides that, to the extent any amount transferred is subject to any distribution restrictions under §1.403(b)–6, the receiving plan imposes restrictions on distributions to the participant or beneficiary whose assets are being transferred that are not less stringent than those imposed on the transferor plan.

(G) If a plan-to-plan transfer does not constitute a complete transfer of the participant's or beneficiary's interest in the section 403(b) plan, the transferee plan treats the amount transferred as a continuation of a *pro rata* portion of the participant's or beneficiary's interest in the section 403(b) plan (for example, a *pro rata* portion of the participant's or beneficiary's interest in any after-tax employee contributions).

(ii) *Accumulated benefit.* The condition in paragraph (b)(3)(i)(D) of this section is satisfied if the transfer would satisfy section 414(l)(1).

(4) *Purchases of permissive service credit by contract-to-plan transfers from a section 403(b) contract to a qualified plan*—(i) *General rule.* If the conditions in paragraph (b)(4)(ii) of this section are met, a section 403(b) plan may provide

for the transfer of assets held in the plan to a qualified defined benefit plan that is a governmental plan (as defined in section 414(d)).

(ii) *Conditions for plan-to-plan transfers.* A transfer may be made under this paragraph (b)(4) only if the transfer is either—

(A) For the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under the receiving defined benefit plan; or

(B) A repayment to which section 415 does not apply by reason of section 415(k)(3).

(c) *Qualified domestic relations orders.* In accordance with the second sentence of section 414(p)(9), any distribution from an annuity contract under section 403(b) (including a distribution from a custodial account or retirement income account that is treated as a section 403(b) contract) pursuant to a qualified domestic relations order is treated in the same manner as a distribution from a plan to which section 401(a)(13) applies. Thus, for example, a section 403(b) plan does not fail to satisfy the distribution restrictions set forth in §1.403(b)–6(b), (c), or (d) merely as a result of distribution made pursuant to a qualified domestic relations order under section 414(p), so that such a distribution is permitted without regard to whether the employee from whose contract the distribution is made has had a severance from employment or another event permitting a distribution to be made under section 403(b). In the case of a plan that is subject to Title I of ERISA, see also section 206(d)(3) of ERISA under which the prohibition against assignment or alienation of plan benefits under section 206(d)(1) of ERISA does not apply to an order that is determined to be a qualified domestic relations order.

(d) *Rollovers to a section 403(b) contract*—(1) *General rule.* A section 403(b) contract may accept a contribution that is an eligible rollover distribution (as defined in section 402(c)(4)) made from another eligible retirement plan (as defined in section 402(c)(8)(B)). Any amount contributed to a section 403(b) contract as an eligible rollover distribution is not taken into account for purposes of the limits in §1.403(b)–4, but, except as otherwise specifically provided (for example, at §1.403(b)–6(i)), is otherwise treated in the same manner as an amount held under a section 403(b) contract for purposes of §§1.403(b)–3 through 1.403(b)–9 and this section.

(2) *Special rules relating to after-tax employee contributions and designated Roth contributions.* A section 403(b) plan that receives an eligible rollover distribution that includes after-tax employee contributions or designated Roth contributions is required to obtain information regarding the employee's section 72 basis in the amount rolled over. A section 403(b) plan is permitted to receive an eligible rollover distribution that includes designated Roth contributions only if the plan permits employees to make elective deferrals that are designated Roth contributions.

(e) *Deemed IRAs.* See regulations under section 408(q) for special rules relating to deemed IRAs.

(f) *Defined benefit plans*—(1) *Defined benefit plans generally.* Except for a TEFRA church defined benefit plan as defined in paragraph (f)(2) of this section, section 403(b) does not apply to any contributions or accrual under a defined benefit plan.

(2) *TEFRA church defined benefit plans.* See section 251(e)(5) of the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248, for a provision permitting certain arrangements established by a church-related organization and in effect on September 3, 1982 (a TEFRA church defined benefit plan) to be treated as a section 403(b) contract even though it is a defined benefit arrangement. In accordance with section 403(b)(1), for purposes of applying section 415 to a TEFRA church defined benefit plan, the accruals under the plan are limited to the maximum amount permitted under section 415(c) when expressed as an annual addition, and, for this purpose, the rules at §1.402(b)–1(a)(2) for determining the present value of an accrual under a nonqualified defined benefit plan also apply for purposes of converting the accrual under a TEFRA church defined benefit plan to an annual addition. See section 415(b) for additional limits applicable to TEFRA church defined benefit plans.

(g) *Other rules relating to section 501(c)(3) organizations.* See section 501(c)(3) and regulations thereunder for the substantive standards for tax-exemption under that section, including the requirement that no part of the organization's net earnings inure to the benefit of any private shareholder or individual. See also sections 4941 (self dealing), 4945 (taxable expenditures), and 4958 (excess benefit transactions), and the regulations thereunder, for rules relating to excise taxes imposed on certain transactions involving organizations described in section 501(c)(3).

§1.403(b)–11 Applicable dates.

(a) *General rule.* Except as otherwise provided in this section, §§1.403(b)–1 through 1.403(b)–10 apply for taxable years beginning after December 31, 2008.

(b) *Collective bargaining agreements.* In the case of a section 403(b) plan maintained pursuant to one or more collective bargaining agreements that have been ratified and in effect on July 26, 2007, §§1.403(b)–1 through 1.403(b)–10 do not apply before the earlier of—

(1) The date on which the last of the collective bargaining agreements terminates (determined without regard to any extension thereof after July 26, 2007); or

(2) July 26, 2010.

(c) *Church conventions; retirement income account.* (1) In the case of a section 403(b) plan maintained by a church-related organization for which the authority to amend the plan is held by a church convention (within the meaning of section 414(e)), §§1.403(b)–1 through 1.403(b)–10 do not apply before the first day of the first plan year that begins after December 31, 2009.

(2) In the case of a loan or other extension of credit to the employer that was entered into under a retirement income account before July 26, 2007, the plan does not fail to satisfy §1.403(b)–9(a)(2)(i)(C) on account of the loan or other extension of credit if the plan takes reasonable steps to eliminate the loan or other extension of credit to the employer before the applicable date for §1.403(b)–9(a)(2) or as promptly as practical thereafter (including taking steps after July 26, 2007 and before the applicable date).

(d) *Special rules for plans that exclude certain types of employees from elective deferrals.* (1) If, on July 26, 2007, a plan excludes any of the following categories of employees, then the plan does not fail

to satisfy §1.403(b)–5(b) as a result of that exclusion before the first day of the first taxable year that begins after December 31, 2009:

(i) Employees who make a one-time election to participate in a governmental plan described in section 414(d) that is not a section 403(b) plan.

(ii) Professors who are providing services on a temporary basis to another educational organization (as defined under section 170(b)(1)(A)(ii)) for up to one year and for whom section 403(b) contributions are being made at a rate no greater than the rate each such professor would receive under the section 403(b) plan of the original educational organization.

(iii) Employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement from eligibility to make elective deferrals.

(2) If, on July 26, 2007, a plan excludes employees who are covered by a collective bargaining agreement from eligibility to make elective deferrals, the plan does not fail to satisfy §1.403(b)–5(b) (relating to universal availability) as a result of that exclusion before the later of—

(i) The first day of the first taxable year that begins after December 31, 2008; or

(ii) The earlier of—

(A) The date on which the related collective bargaining agreement terminates (determined without regard to any extension thereof after July 26, 2007); or

(B) July 26, 2010.

(3) In the case of a governmental plan (as defined in section 414(d)) for which the authority to amend the plan is held by a legislative body that meets in legislative session, the plan does not fail to satisfy §1.403(b)–5(b) as a result of any exclusion in paragraph (d)(1)(i), (d)(1)(ii), (d)(1)(iii), or (d)(2) of this section before the earlier of —

(i) The close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2009; or

(ii) January 1, 2011.

(e) *Special rules for plans that permit in-service distributions.* (1) Section 1.403(b)–6(b) does not apply to a contract issued by an insurance company before January 1, 2009.

(2) Any amendment to comply with the requirements of §1.403(b)–6 (disregarding paragraph (e)(1) of this section) that is adopted before January 1, 2009, or such later date as may be permitted under guidance issued by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), does not violate section 204(g) of the Employee Retirement Income Security Act of 1974 to the extent the amendment eliminates or reduces a right to receive benefit distributions during employment.

(f) *Special rule for life insurance contracts.* Section 1.403(b)–8(c)(2) does not apply to a contract issued before September 24, 2007.

(g) *Special rule for contracts received in an exchange.* Section 1.403(b)–10(b)(2) does not apply to a contract received in an exchange that occurred on or before September 24, 2007 if the exchange (including the contract received in the exchange) satisfies such rules as the Commissioner has prescribed in guidance of general applicability at the time of the exchange.

(h) *Special rule for coordination with regulations under section 415.* Section 1.403(b)–3(b)(4)(ii) is applicable for taxable years beginning on or after July 1, 2007.

(i) *Special rule for coordination with regulations under section 402A.* Sections 1.403(b)–3(c), 1.403(b)–7(e), and 1.403(b)–10(d)(2) are applicable with respect to taxable years beginning on or after January 1, 2007.

§1.403(d)–1 [Removed]

Par. 8. Section 1.403(d)–1 is removed.

Par. 9. Section 1.414(c)–5 is redesignated as §1.414(c)–6 and new §1.414(c)–5 is added to read as follows:

§1.414(c)–5 Certain tax-exempt organizations.

(a) *Application.* This section applies to an organization that is exempt from tax under section 501(a). The rules of this section only apply for purposes of determining when entities are treated as the same employer for purposes of section 414(b), (c), (m), and (o) (including the sections referred to in section 414(b), (c), (m), (o), and (t)), and are in addition to the rules otherwise applicable under section 414(b), (c), (m), and (o) for determining when entities are treated as the same employer. Except to the extent set forth in paragraphs (d), (e), and (f) of this section, this section does not apply to any church, as defined in section 3121(w)(3)(A), or any qualified church-controlled organization, as defined in section 3121(w)(3)(B).

(b) *General rule.* In the case of an organization that is exempt from tax under section 501(a) (an exempt organization) whose employees participate in a plan, the employer with respect to that plan includes the exempt organization whose employees participate in the plan and any other organization that is under common control with that exempt organization. For this purpose, common control exists between an exempt organization and another organization if at least 80 percent of the directors or trustees of one organization are either representatives of, or directly or indirectly controlled by, the other organization. A trustee or director is treated as a representative of another exempt organization if he or she also is a trustee, director, agent, or employee of the other exempt organization. A trustee or director is controlled by another organization if the other organization has the general power to remove such trustee or director and designate a new trustee or director. Whether a person has the power to remove or designate a trustee or director is based on facts and circumstances. To illustrate the rules of this paragraph (b), if exempt organization A has the power to appoint at least 80 percent of the trustees of exempt organization B (which is the owner of the outstanding shares of corporation C, which is not an exempt organization) and to control at least 80 percent of the directors of exempt organization D, then, under this paragraph (b) and §1.414(b)–1, entities A, B, C, and D are treated as the same employer with respect to any plan maintained by A, B, C, or D for purposes of the sections referenced in section 414(b), (c), (m), (o), and (t).

(c) *Permissive aggregation with entities having a common exempt purpose*—(1) *General rule.* For purposes of this section, exempt organizations that maintain a plan to which section 414(c) applies that covers one or more employees from each organization may treat themselves as under common control for purposes of

section 414(c) (and, thus, as a single employer for all purposes for which section 414(c) applies) if each of the organizations regularly coordinates their day-to-day exempt activities. For example, an entity that provides a type of emergency relief within one geographic region and another exempt organization that provides that type of emergency relief within another geographic region may treat themselves as under common control if they have a single plan covering employees of both entities and regularly coordinate their day-to-day exempt activities. Similarly, a hospital that is an exempt organization and another exempt organization with which it coordinates the delivery of medical services or medical research may treat themselves as under common control if there is a single plan covering employees of the hospital and employees of the other exempt organization and the coordination is a regular part of their day-to-day exempt activities.

(2) *Authority to permit aggregation.* (i) For determining when entities are treated as the same employer under section 414(b), (c), (m), and (o), the Commissioner may issue rules of general applicability, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), permitting other types of combinations of entities that include exempt organizations to elect to be treated as under common control for one or more specified purposes if—

(A) There are substantial business reasons for maintaining each entity in a separate trust, corporation, or other form; and

(B) Such treatment would be consistent with the anti-abuse standards in paragraph (f) of this section.

(ii) For example, this authority might be exercised in any situation in which the organizations are so integrated in their operations as to effectively constitute a single coordinated employer for purposes of section 414(b), (c), (m), and (o), including common employee benefit plans.

(d) *Permissive disaggregation between qualified church controlled organizations and other entities.* In the case of a church plan (as defined in section 414(e)) to which contributions are made by more than one common law entity, any employer may apply paragraphs (b) and (c) of this section to those entities that are not a church (as defined in section 403(b)(12)(B) and §1.403(b)–2) separately from those entities that are churches. For example, in the case of a group of entities consisting of a church (as defined in section 3121(w)(3)(A)), a secondary school (that is treated as a church under §1.403(b)–2), and several nursing homes each of which receives more than 25 percent of its support from fees paid by residents (so that none of them is a qualified church-controlled organization under §1.403(b)–2 and section 3121(w)(3)(B)), the nursing homes may treat themselves as being under common control with each other, but not as being under common control with the church and the school, even though the nursing homes would be under common control with the school and the church under paragraph (b) of this section.

(e) *Application to certain church entities under section 3121(w)(3).* [Reserved].

(f) *Anti-abuse rule.* In any case in which the Commissioner determines that the structure of one or more exempt organizations (which may include an exempt organization and an entity that is not exempt from income tax) or the positions taken by those organizations has the effect of avoiding or evading any requirements imposed under section 401(a), 403(b), or 457(b), or any applicable section (as defined in section 414(t)), or any other provision for which section 414(c) applies, the Commissioner may treat an entity as under common control with the exempt organization.

(g) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. (i) *Facts.* Organization A is a tax-exempt organization under section 501(c)(3) which owns 80% or more of the total value of all classes of stock of corporation B, which is a for profit organization.

(ii) *Conclusion.* Under paragraph (a) of this section, this section does not alter the rules of section 414(b) and (c), so that organization A and corporation B are under common control under §1.414(c)–2(b).

Example 2. (i) *Facts.* Organization M is a hospital which is a tax-exempt organization under section 501(c)(3) and organization N is a medical clinic which is also a tax-exempt organization under section 501(c)(3). N is located in a city and M is located in a nearby suburb. There is a history of regular coordination of day-to-day activities between M and N, including periodic transfers of staff, coordination of staff training, common sources of income, and coordination of budget and operational goals. A single section 403(b) plan covers professional and staff employees of both the hospital and the medical clinic. While a number of members of the board of directors of M are also on the board of directors of N, there is less than 80% overlap in board membership. Both organizations have approximately the same percentage of employees who are highly compensated and have appropriate business reasons for being maintained in separate entities.

(ii) *Conclusion.* M and N are not under common control under this section, but, under paragraph (c) of this section, may chose to treat themselves as under common control, assuming both of them act in a manner that is consistent with that choice for purposes of §1.403(b)–5(a), sections 401(a), 403(b), and 457(b), and any other applicable section (as defined in section 414(t)), or any other provision for which section 414(c) applies.

Example 3. (i) *Facts.* Organizations O and P are each tax-exempt organizations under section 501(c)(3). Each organization maintains a qualified plan for it employees, but one of the plans would not satisfy section 410(b) (or section 401(a)(4)) if the organizations were under common control. The two organizations are closely related and, while the organizations have several trustees in common, the common trustees constitute fewer than 80 percent of the trustees of either organization. Organization O has the power to remove any of the trustees of P and to select the slate of replacement nominees.

(ii) *Conclusion.* Under these facts, pursuant to paragraphs (b) and (f) of this section, the Commissioner treats the entities as under common control.

(h) *Applicable date.* This section applies for plan years beginning after December 31, 2008.

Par. 10. For each entry listed in the "Location" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Location	Remove	Add
§1.101–1(a)(2)(ii)	paragraph (a) or (b) of §1.403(b)–1	§1.403(b)–3
§1.101–1(a)(2)(ii)	paragraph (c)(3) of §1.403(b)–1	§1.403(b)–7
§1.401(a)(9)–1, A–1	§1.403(b)–3	§1.403(b)–6(e)

Location	Remove	Add
§1.401(a)(31)–1, introductory text	1.403(b)–2	1.403(b)–7(b)
§1.401(a)(31)–1, A–1(b)(3)	§1.403(b)–2	§1.403(b)–7(b)
§1.402(c)–2, introductory text	1.403(b)–2	1.403(b)–7(b)
§1.402(c)–2, A–1(b)(4)	§1.403(b)–2	§1.403(b)–7(b)
§1.402(f)–1, introductory text	1.403(b)–2	1.403(b)–7(b)
§1.403(a)–1(a)	§1.403(b)–1	§§1.403(b)–1 through 1.403(b)–10
§1.403(c)–1, all locations	§1.403(b)–1(b)	§1.403(b)–3
§1.403(c)–1, all locations	§1.403(b)–1(b)(2)	§1.403(b)–3(c)

PART 31—EMPLOYMENT TAXES, INCOME TAXES, PENALTIES, PENSIONS, RAILROAD RETIREMENT, REPORTING AND RECORDKEEPING REQUIREMENTS, SOCIAL SECURITY, UNEMPLOYMENT COMPENSATION

Par. 11. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 12. For each entry listed in the "Location" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Location	Remove	Add
§31.3405(c)–1, all locations	§1.403(b)–2, Q&A–1	§1.403(b)–7(b)
§31.3405(c)–1, A–1(b)	§1.403(b)–2, Q&A–3	§1.403(b)–7(b)
§31.3405(c)–1, A–1(b)	§1.403(b)–2, Q&A–1 and Q&A–2	§1.403(b)–7(b)
§31.3405(c)–1, A–2	§1.403(b)–2, Q&A–2	§1.403(b)–7(b)

PART 54—EXCISE TAXES, PENSIONS, REPORTING AND RECORDKEEPING REQUIREMENTS

Par. 13. The authority citation for part 54 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 14. For the entry listed in the "Location" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Location	Remove	Add
§54.4974–2, A–3(a)(2)	§1.403(b)–3	§1.403(b)–6(e)

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 15. The authority citation for part 602 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

Par. 16. In §602.101, paragraph (b) is amended by removing the entry for §1.403(b)–2 and adding entries to the table for §§1.403(b)–7 and 1.402(b)–10 to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.403(b)–7	1545–1341
1.403(b)–10	1545–2068
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 2, 2007.

Eric Solomon,
Assistant Secretary of Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 23, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 26, 2007, 72 F.R. 41127)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 953.—Insurance Income

Final regulations under section 1502 of the Code allow the Internal Revenue Service to appoint a domestic substitute agent for a consolidated group when the group's parent is a foreign corporation that is treated as a domestic corporation as the result of a section 953(d) election. See T.D. 9343, page 533.

Section 1248.—Gain From Certain Sales or Exchanges of Stock in Certain Foreign Corporations

26 CFR 1.1248–1: Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

T.D. 9345

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Section 1248 Attribution Principles

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 1248 of the Internal Revenue Code (Code) that provide guidance for determining the earnings and profits attributable to stock of controlled foreign corporations (or former controlled foreign corporations) that are (were) involved in certain nonrecognition transactions. The final regulations are necessary in order to supplement and clarify existing guidance in the regulations under section 1248. The final regulations affect persons subject to the regulations under section 1248, as well as persons to which regulations under other Code provisions, such as section 367(b), apply to the extent that those regulations incorporate the principles of the section 1248 regulations. In addition, the final regulations provide that with respect to the sale by a foreign partnership of the stock of a corporation, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporation for purposes of section 1248.

DATES: *Effective Date:* These regulations are effective on July 30, 2007.

Applicability Dates: For dates of applicability, see §§1.1248–1(g) and 1.1248–8(d).

FOR FURTHER INFORMATION CONTACT: Michael Gilman at (202) 622–3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On June 2, 2006, proposed revisions to the regulations under section 1248(a) of the Code (REG–135866–02, 2006–27 I.R.B. 34) were published in the **Federal Register** (71 FR 31985–01). On August 14, 2006, two corrections to those proposed regulations were published in the **Federal Register** (published in the I.R.B. as Announcement 2006–64, 2006–37 I.R.B. 447 [71 FR 46415], and Announcement 2006–65, 2006–37 I.R.B. 447 [71 FR 46416]). Two written comments were received. A public hearing was not requested and none was held. After consideration of the written comments and other comments, the June 2, 2006, proposed regulations are adopted as amended by this Treasury decision.

Summary of Comments and Explanation of Revisions

With respect to attribution of earnings and profits to stock of an acquiring corporation held by a non-exchanging shareholder, §1.1248–8(b)(4) of the proposed regulations provides a rule by cross-reference to §1.1248–2 or §1.1248–3 (whichever is applicable) and §1.1248–8(b)(6) (as applicable). A commentator asserted that the proposed regulations did not adequately explain which earnings and profits were attributed to the stock of the non-exchanging shareholder. This commentator thought that the rule was better explained in the preamble to the proposed regulations, which states that generally the earnings and profits attributable to stock of an acquiring corporation held by a non-exchanging shareholder immediately prior to a restructuring transaction continue to be attributed to such stock, and the earnings and profits of the acquired corporation accumulated prior to the restructuring transaction attributable to the stock of an acquired corporation are not attributed to the non-exchanging shareholder's stock in the acquiring corporation. In order to clarify the regulations, this language from the preamble to the proposed regulations is included in §1.1248–8(b)(4) of the final regulations.

Under §1.1248–1(a)(4) of the proposed regulations, the partners in a foreign partnership shall be treated as selling or exchanging their proportionate share of stock of a corporation sold or exchanged by the foreign partnership. The proposed regulations also apply section 1248(a) in cases where the stock in a corporation that is sold or exchanged is held through tiers of foreign partnerships. This treatment is necessary to reflect properly each partner's share of the corporation's earnings and profits as a dividend.

A commentator noted that §1.1248–1(a)(4) of the proposed regulations could be read to apply to the sale by a partner of its interest in a partnership holding the stock of a corporation. The Treasury Department and the IRS did not intend that interpretation because it would be contrary to section 1248(g)(2)(B). An amount that is received by a partner in exchange for all or part of its partnership interest is treated as ordinary income under section 751(a) and (c) to the extent attributable to stock in a foreign corporation as described in section 1248. Section 1248(g)(2)(B) provides that section 1248 will not apply if any other provision of the Code treats an amount as ordinary income. Accordingly, §1.1248–1(a)(4) in the final regulations is revised to clarify that a foreign partnership is treated as an aggregate for this purpose only when a foreign partnership sells or exchanges stock of a corporation. Finally, a commentator requested that the final regulations allow a taxpayer to elect to apply the rule in §1.1248–1(a)(4) to taxable years ending before the effective date of the final regulations. The Treasury Department and the IRS regard this rule as a clarification of existing law, but recognize that some practitioners have expressed the view that prior law was not entirely clear. Accordingly, the final regulations allow taxpayers to apply the rule in §1.1248–1(a)(4) to open years provided that the taxpayer consistently applies the rule in all such years. A partner makes this election by treating its distributive share of gain attributable to a sale of shares in a controlled foreign corporation as gain recognized on a sale or exchange of stock in a foreign corporation within the meaning of section 1248(a).

In order to clarify the application of §1.1248–8, the definition of controlled foreign corporation at §1.1248–8(b)(1)(iii) has been revised to provide that a controlled foreign corporation includes corporations described in either section 953(c)(1)(B) or section 957.

A commentator requested the addition of an example to §1.367(b)–4(d) to clarify that earnings and profits attributable to certain lower-tier subsidiaries are not taken into account in determining the all earnings and profits amount attributable to transactions described in §1.367(b)–3. In response to this comment, such an example is included in §1.367(b)–4(d) of the final regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of 5 U.S.C. chapter 5 does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act, 5 U.S.C. chapter 6, does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of the final regulations is Michael I. Gilman of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.367(b)–2(c)(1) and (2) also issued under 26 U.S.C. 367(b)(1) and (2).

Section 1.367(b)–2(d)(3) also issued under 26 U.S.C. 367(b)(1) and (2).* * *

Section 1.367(b)–4(d) also issued under 26 U.S.C. 367(b)(1) and (2). * * *

Sections 1.1248–1(a)(1), (4), and (5) also issued under 26 U.S.C. 1248(a) and (c)(1) and (2).* * *

Section 1.1248–8 also issued under 26 U.S.C. 1248(a) and (c)(1) and (2). * * *

§1.367(b)–2 [Amended]

Par. 2. Section 1.367(b)–2 is amended by:

1. Removing the language ", as modified by §1.367(b)–4(d) (as applicable)." from the last sentence of paragraph (c)(1)(ii) and adding the language ". See §1.1248–8." in its place.

2. Removing paragraphs (c)(2) *Example 4* and (d)(3)(ii).

3. Removing the language ", as modified by paragraph (d)(3)(ii) of this

section and §1.367(b)–4(d) (as applicable)." from the last sentence of paragraph (d)(3)(i)(B)(2) and adding the language ". See §1.1248–8." in its place.

4. Redesignating paragraph (d)(3)(iii) as paragraph (d)(3)(ii).

Par. 3. Section 1.367(b)–4(d) is revised to read as follows:

§1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

* * * * *

(d) *Rules for subsequent sales or exchanges*—(1) *Rule.* If an exchanging shareholder (as defined in §1.1248–8(b)(1)(iv)) is not required to include in income as a deemed dividend the section 1248 amount under paragraph (b) of this section in a section 367(b) exchange described in paragraph (a) of this section (non-inclusion exchange), then, for purposes of applying section 367(b) or section 1248 to subsequent sales or exchanges, and subject to the limitation of §1.367(b)–2(d)(3)(ii) (in the case of a transaction described in §1.367(b)–3), the determination of the earnings and profits attributable to the stock an exchanging shareholder receives in the non-inclusion exchange shall be determined pursuant to the rules of section 1248 and the regulations under that section.

(2) *Example.* The following example illustrates the rules of this section. For purposes of the example, assume that—

(i) There is no immediate gain recognition pursuant to section 367(a)(1) and the regulations under that section (either through operation of the rules or because the appropriate parties have entered into a gain recognition agreement under §§1.367(a)–3(b) and 1.367(a)–8);

(ii) References to earnings and profits are to earnings and profits that would be includible in income as a dividend under section 1248 and the regulations under that section if stock to which the earnings and profits are attributable were sold or exchanged by its shareholder;

(iii) Each corporation has only a single class of stock outstanding and uses the calendar year as its taxable year; and

(iv) Each transaction is unrelated to all other transactions.

Example. Acquisition of the stock of a foreign corporation that controls a foreign acquiring corporation in a reorganization described in section 368(a)(1)(C). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a controlled foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a controlled foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of FC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to FC2 in exchange for 80% of the voting stock of FC. CFC1 transfers the voting stock of FC to DC1 and the CFC1 stock is cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), FC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits. From January 1, year 4, until December 31, year 5, FC (a controlled foreign corporation after the restructuring transaction) accumulates an additional $50 of earnings and profits. FC2, a controlled foreign corporation after the restructuring transaction, accumulates $100 of earnings and profits from January 1, year 4, until December 31, year 5. On December 31, year 5, FC is liquidated into DC1 in a transaction described in section 332.

(ii) *Result.* Generally, this paragraph (d) requires that DC1 include in income the earnings and profits attributable to its stock in FC as determined under §1.1248–8. However, since the liquidation of FC into DC1 is a transaction described in §1.367(b)–3, the earnings and profits attributable to the stock of FC are limited by §1.367(b)–2(d)(3)(ii) to that portion of the earnings and profits accumulated by FC itself before or after the restructuring transaction, and do not include the earnings and profits of FC's subsidiaries accumulated before or after the restructuring transaction. Thus, DC1 will include $40 of earnings and profits in income (80% of the $50 of earnings and profits accumulated by FC after the restructuring transaction).

Par. 4. Section 1.1248–1 is amended by:

1. Removing the language "(or was considered as held by reason of the application of section 1223)" from the first sentence of paragraph (a)(1) and adding the language "(or was considered as held by reason of the application of section 1223, taking into account §1.1248–8)" in its place and adding a new third sentence.

2. Redesignating paragraph (a)(4) as paragraph (a)(5).

3. Adding new paragraphs (a)(4) and (g).

4. Adding *Example 4* in newly-designated paragraph (a)(5).

The additions read as follows:

§1.1248–1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

(a) *In general.* (1) * * * See §1.1248–8 for additional rules regarding the attribution of earnings and profits to the stock of a foreign corporation following certain nonrecognition transactions. * * *

* * * * *

(4) For purposes of paragraph (a)(1) of this section, if a foreign partnership sells or exchanges stock of a corporation, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporation. Stock which is considered to have been sold or exchanged by a partner by reason of the application of this paragraph (a)(4) shall for purposes of applying such sentence be treated as actually sold or exchanged by such partner.

(5) * * *

Example 4. (i) *Facts.* X, a domestic corporation, and Y, a foreign corporation that is not a controlled foreign corporation, are partners in foreign partnership Z. X has a 60% interest in Z, and Y has a 40% interest in Z. All parties are calendar year taxpayers. On January 1, year 1, Z forms foreign corporation H, a controlled foreign corporation that conducts a business in Country C. Z and H's functional currency is the United States dollar. In years 1 and 2, H did not earn subpart F income as defined in section 952(a). On December 31, year 2, Z sells all of the H stock for $600 when Z's adjusted basis in the stock is $100. Therefore, Z recognizes a gain of $500 on the sale, of which $300 is allocable to X as a 60% partner. At the time of the sale, H had $300 of earnings and profits, $180 of which (that is, 60% of $300) is attributable to X's 60% share of the H stock.

(ii) *Result.* Pursuant to section 1248(a) and paragraphs (a)(1) and (4) of this section, X and Y are treated as selling 60% and 40%, respectively, of the H stock. X includes in its gross income as a dividend $180 of the gain recognized on the sale. Because Y is a foreign corporation that is not a CFC, neither section 1248 nor section 964 applies to the sale of Y's 40% share of the H stock.

(iii) *Alternative facts.* If, instead, X owned its 60% interest in Z through another foreign partnership, the result would be the same.

* * * * *

(g) *Effective/applicability date.* The third sentence in paragraph (a)(1), paragraph (a)(4), and paragraph (a)(5) *Example 4* of this section apply to income inclusions that occur on or after July 30, 2007. A taxpayer may elect to apply paragraph (a)(4) of this section to income inclusions in open taxable years provided that it consistently applies paragraph (a)(4) for income inclusions in the first year for

which the election is applicable and in all subsequent years.

§§1.1248–2, 1.1248–3, 1.1248–7 [Amended]

Par. 5. In §§1.1248–2, 1.1248–3, and 1.1248–7, for each entry in the "Section" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Section	Remove	Add
§1.1248–2(a)(1)	(or was considered to be held by reason of the application of section 1223)	(or was considered to be held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(a)(2)(ii)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(a)(3)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(c)(4)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(1), introductory text	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(2)	(or is considered as held by reason of the application of section 1223)	(or is considered as held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(3)(i)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(a)(1)	(or was considered to be held by reason of the application of section 1223)	(or was considered to be held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(c)(1)(ii)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(e)(2)(i)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(e)(3)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(e)(5)	(or another person who actually owned the stock during such taxable year and whose holding of the stock is attributed by reason of the application of section 1223 to the person who sold or exchanged the stock)	(or another person who actually owned the stock during such taxable year and whose holding of the stock is attributed by reason of the application of section 1223, taking into account §1.1248–8, to the person who sold or exchanged the stock)

Section	Remove	Add
§1.1248–3(e)(6), two places	by reason of the application of section 1223 to such person	by reason of the application of section 1223 to such person, taking into account §1.1248–8
§1.1248–3(f)(2)(ii)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(f)(5)(ii)	(during the period such stock was considered to be held by such person by reason of the application of section 1223)	(during the period such stock was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(f)(5)(iv)	(during the period such share (or block) was considered to be held by such person by reason of the application of section 1223)	(during the period such share (or block) was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(3)(i)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(3)(iii)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(4), introductory text	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)

Par. 6. Section 1.1248–8 is added to read as follows:

§1.1248–8 Earnings and profits attributable to stock following certain non-recognition transactions.

(a) *Scope.* This section sets forth rules for the attribution of earnings and profits for purposes of section 1248 and §1.1248–1(a)(1) and to supplement the rules in §§1.1248–2 and 1.1248–3 with respect to—

(1) *Stock that an exchanging shareholder receives, or an acquiring corporation receives, in restructuring transactions.* Except as otherwise provided in this paragraph (a), stock of a foreign corporation that an exchanging shareholder receives, or an acquiring corporation receives, pursuant to a restructuring transaction (as defined in paragraph (b)(1)(vii) of this section) in which the holding period of such stock is determined by application of section 1223(1) or 1223(2), whichever is appropriate. This section shall not apply to an exchange otherwise described in this paragraph (a)(1) if, as a result of the exchange, the exchanging shareholder is required to include in income as a deemed dividend the section 1248 amount pursuant to §1.367(b)–4(b). See paragraphs (b)(2) and (3) of this section;

(2) *Nonexchanging shareholders.* Stock of a foreign corporation that participates in a restructuring transaction that is held by a non-exchanging shareholder (as defined in paragraph (b)(1)(vi) of this section) in the restructuring transaction. See paragraph (b)(4) of this section;

(3) *Application of section 381.* Stock of a foreign corporation that receives assets in a transfer to which section 361(a) applies in connection with a reorganization described in section 368(a)(1)(A), (C), (D), (F), or (G), or in a distribution to which section 332 applies, and to which section 381(c)(2)(A) and §1.381(c)(2)–1(a) apply. See paragraph (b)(6) of this section; or

(4) *Section 332 liquidations.* Stock of a foreign corporation that receives the assets and liabilities of a foreign corporation in a complete liquidation described in section 332 if the foreign distributee is a foreign corporate shareholder (as defined in paragraph (b)(1)(v) of this section) of the liquidating corporation. See paragraph (c) of this section.

(b) *Earnings and profits attributable to stock following a restructuring transaction*—(1) *Definitions.* The following definitions apply for purposes of this section:

(i) *Acquired corporation* is a corporation whose stock or assets are acquired in exchange for stock in (or stock in and other property of) either the acquiring corporation or a foreign corporation that controls, within the meaning of section 368(c), the acquiring corporation in a restructuring transaction.

(ii) *Acquiring corporation* is a corporation that acquires the stock or assets of an acquired corporation in a restructuring transaction.

(iii) *Controlled foreign corporation* is a corporation described in either section 953(c)(1)(B) or section 957.

(iv) *Exchanging shareholder* is a person that exchanges—

(A) In a restructuring transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 354, 356, or 361(a), stock in an acquired corporation for stock in either a foreign acquiring corporation or a foreign corporation that is in control, within the meaning of sec-

tion 368(c), of an acquiring corporation (whether domestic or foreign); or

(B) In a restructuring transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 351, property (including stock) for stock in a foreign acquiring corporation.

(v) *Foreign corporate shareholder* is a foreign corporation that—

(A) Owns stock of another foreign corporation; and

(B) Has a section 1248 shareholder that is also a section 1248 shareholder of the other foreign corporation.

(vi) *Non-exchanging shareholder* is, at the time the acquiring corporation participates in a restructuring transaction, either a section 1248 shareholder or a foreign corporate shareholder of the acquiring corporation that is not an exchanging shareholder with respect to that corporation.

(vii) *Restructuring transaction* is a transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 351, 354, 356, or 361.

(viii) *Section 1248 shareholder* is any United States person that satisfies the ownership requirements of section 1248(a)(2) and §1.1248–1(a)(2) with respect to a foreign corporation.

(2) *Earnings and profits attributable to stock that an exchanging shareholder receives in a restructuring transaction.* Where, in a restructuring transaction, an exchanging shareholder receives stock in a foreign corporation, the holding period of which is determined under section 1223(1), and the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign corporation immediately after the restructuring transaction, the earnings and profits attributable to the stock the exchanging shareholder receives shall be determined pursuant to the rules in paragraphs (b)(2)(i), (ii), and (iii) of this section.

(i) *Exchanging shareholder exchanges property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder.* Where the exchanging shareholder exchanges in a restructuring transaction property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder immediately before such transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7) *Example 1* of this section.

(ii) *Exchanging shareholder exchanges stock of a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder.* Except as provided in paragraph (b)(2)(iii) of this section, where the exchanging shareholder exchanges in a restructuring transaction stock of a foreign acquired corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder immediately before such restructuring transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall be the sum of the earnings and profits attributable to—

(A) The stock of the foreign acquired corporation exchanged (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable) that was accumulated before the restructuring transaction; and

(B) The stock of the foreign corporation that the exchanging shareholder receives in the restructuring transaction (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable), without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7) *Example 2*, *Example 4*, and *Example 6* of this section.

(iii) *Exchanging shareholder receives stock in a foreign corporation that controls a domestic acquiring corporation.* Where the acquiring corporation is a domestic corporation and the exchanging shareholder receives in a restructuring transaction stock in a foreign corporation that controls (within the meaning of section 368(c)) the domestic acquiring corporation, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall consist solely of the amount of earnings and profits attributable to such stock (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable) without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7) *Example 5* of this section.

(3) *Earnings and profits attributable to stock in a foreign corporation certain acquiring corporations receive in a restructuring transaction.* Where an acquiring corporation receives, in a restructuring transaction, stock in a foreign acquired corporation, the holding period of which is determined under section 1223(2), and the acquiring corporation is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign acquired corporation immediately after the restructuring transaction, the earnings and profits attributable to the foreign acquired corporation stock that the acquiring corporation receives shall be determined pursuant to the rules in paragraphs (b)(3)(i) and (ii) of this section.

(i) *Stock of a foreign corporation with respect to which the exchanging shareholder is neither a section 1248 shareholder nor a foreign corporate shareholder.* The earnings and profits attributable to the stock of the foreign acquired corporation that the acquiring corporation receives in a restructuring transaction where the exchanging shareholder is neither a section 1248 shareholder nor a foreign corporate shareholder with respect to that foreign acquired corporation immediately before the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, without regard to any portion of the section 1223(2) holding period in that stock that is prior to the restructuring transaction.

(ii) *Stock of a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder.* The earnings and profits attributable to the stock of a foreign acquired corporation that the acquiring corporation receives in the restructuring transaction where the exchanging shareholder is either a

section 1248 shareholder or a foreign corporate shareholder with respect to that foreign corporation immediately before the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, with regard to the portion of the section 1223(2) holding period of the stock that the exchanging shareholder took into account for purposes of attributing earnings and profits to that stock (determined in accordance with this section). See paragraph (b)(7) *Example 3*, *Example 5*, and *Example 7* of this section.

(4) *Earnings and profits attributable to stock held by a non-exchanging shareholder in a foreign acquiring corporation.* (i) Except to the extent paragraph (b)(4)(ii) of this section applies, the earnings and profits attributable to stock of a foreign acquiring corporation held by a non-exchanging shareholder immediately prior to a restructuring transaction continue to be attributed to such stock, and the earnings and profits of the acquired corporation accumulated prior to the restructuring transaction attributable to the stock of an acquired corporation are not attributed to the non-exchanging shareholder's stock in the foreign acquiring corporation. See §1.1248–2 or §1.1248–3 (whichever is applicable) and, as applicable, paragraph (b)(6) of this section; see also paragraph (b)(7) *Example 2* and *Example 4* of this section.

(ii) Where a non-exchanging shareholder holds stock in a foreign corporation that is also an exchanging shareholder and a foreign acquiring corporation in the same restructuring transaction—

(A) The earnings and profits attributable to such stock shall be the sum of the earnings and profits attributable to the stock of such foreign corporation immediately before the restructuring transaction (including amounts attributed under section 1248(c)(2)) and the earnings and profits attributable to the stock of the foreign acquiring corporation accumulated after the restructuring transaction (including amounts attributed under section 1248(c)(2)); and

(B) Paragraph (b)(6) of this section applies. See paragraph (b)(7) *Example 8* of this section.

(iii) Where the acquiring corporation is a foreign corporate shareholder with respect to stock of a foreign acquired corporation, paragraph (b)(3) of this section shall not apply for purposes of determining the earnings and profits attributable to stock in the foreign acquiring corporation owned by a non-exchanging shareholder thereof (see section 1248(c)(2)). See paragraph (b)(7) *Example 6* of this section.

(5) *Reduction in earnings and profits attributable to stock to prevent multiple inclusions with respect to the same earnings and profits.* To the extent consistent with the principles of section 1248, adjustments to earnings and profits attributable to stock shall be made such that section 1223(1) and (2) and this section are applied in a manner that results in earnings and profits being taken into account only once. Thus, for example, when a controlled foreign corporation sells or exchanges all or part of the stock of another foreign corporation to which earnings and profits are attributable pursuant to this paragraph (b) or paragraph (c) of this section, proportionate reductions shall be made to the earnings and profits attributed to the stock of the selling foreign corporate shareholder owned by a section 1248 shareholder. See paragraph (b)(7) *Example 7* of this section.

(6) *Special rule regarding section 381.* Solely for purposes of determining the earnings and profits (or deficit in earnings and profits) attributable to stock pursuant to this paragraph (b), the earnings and profits of a corporation shall not include earnings and profits that are treated as received or incurred under section 381(c)(2)(A) and §1.381(c)(2)–1(a). See paragraph (b)(7) *Example 4* of this section.

(7) *Examples.* The application of this paragraph (b) is illustrated by the following examples. Unless otherwise indicated, in the following examples assume that—

(i) There is no immediate gain recognition pursuant to section 367(a)(1) and the regulations under that section (either through operation of the rules or because the appropriate parties have entered into a gain recognition agreement under §§1.367(a)–3(b) and 1.367(a)–8);

(ii) There is no income inclusion required pursuant to section 367(b) and the regulations under that section, and all reporting requirements in those regulations are complied with;

(iii) References to earnings and profits are to earnings and profits that would be includible in income as a dividend under section 1248 and the regulations under that section if stock to which the earnings and profits are attributable were sold or exchanged by its shareholder;

(iv) Each corporation has only a single class of stock outstanding and uses the calendar year as its taxable year; and

(v) Each transaction is unrelated to all other transactions.

Example 1. A section 351 exchange of property other than stock in a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder. (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC, a foreign corporation, since CFC's formation on January 1, year 3. On December 31, year 5, DC2, a domestic corporation unrelated to DC1, contributes property it has held since January 1, year 1, to CFC in exchange for voting stock of CFC in a restructuring transaction that is an exchange under section 351. The property that DC2 contributes is not stock in a foreign corporation with respect to which DC2 was either a section 1248 shareholder or a foreign corporate shareholder. DC2 receives 80% of the voting stock of CFC in the restructuring transaction and its holding period in that CFC stock, determined pursuant to section 1223(1), began on January 1, year 1. CFC has $100 of accumulated earnings and profits on December 31, year 5. On December 31, year 7, when the accumulated earnings and profits of CFC are $200, DC2, a section 1248 shareholder with respect to CFC, sells its CFC stock.

(ii) *Result.* Under paragraph (b)(2)(i) of this section, the earnings and profits attributable to the CFC stock sold by DC2 are $80. This amount consists of none of the $100 of earnings and profits accumulated by CFC before the restructuring transaction, and 80% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

Example 2. A section 351 exchange of controlled foreign corporation stock by a United States person for stock in a controlled foreign corporation in a restructuring transaction. (i) *Facts.* The facts are the same as in *Example 1* except as follows. The property that DC2 contributes is 100% of the stock in CFC2, a foreign corporation. DC2 has owned all the stock of CFC2 since CFC2's formation on January 1, year 2, and CFC2 has $200 of earnings and profits as of December 31, year 5. CFC2 does not accumulate any additional earnings and profits from December 31, year 5, to December 31, year 7. On December 31, year 7, when the accumulated earnings and profits of CFC are $200, DC2, a section 1248 shareholder with respect to CFC, sells its CFC stock. Also on that date, DC1 sells its CFC stock.

(ii) *Result.* (A) *DC2 sale.* Pursuant to paragraph (b)(2)(ii) of this section, the earnings and profits attributable to the CFC stock sold by DC2 are $280. This amount consists of all of the $200 of earnings and profits of CFC2 accumulated before the restructuring transaction (see also section 1248(c)(2)), none of the $100 of earnings and profits accumulated by CFC before the restructuring transaction, and 80% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

(B) *DC1 sale.* Pursuant to paragraph (b)(4) of this section, the earnings and profits attributable to

the CFC stock sold by DC1, a non-exchanging shareholder in the restructuring transaction, are $120. This amount consists of all of the $100 of earnings and profits of CFC accumulated before the restructuring transaction, none of the $200 of earnings and profits of CFC2 accumulated before the restructuring transaction, and 20% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

Example 3. A section 351 exchange of controlled foreign corporation stock by a United States person for stock in a domestic corporation in a restructuring transaction. (i) *Facts.* DC1, a domestic corporation, has owned all of the stock of CFC, a foreign corporation, since CFC's formation on January 1, year 1. DC1 has also owned all the stock of DC2, a domestic corporation, since DC2's formation on January 1, year 1. On December 31, year 2, DC1 contributes the stock of CFC to DC2 in exchange for stock in DC2 in a restructuring transaction that is an exchange described in section 351. On December 31, year 2, CFC has $100 of accumulated earnings and profits. DC2 has a basis in the CFC stock determined under section 362, and is considered to have held the CFC stock since January 1, year 1, pursuant to section 1223(2). On December 31, year 4, when the accumulated earnings and profits of CFC are still $100, DC2 sells its CFC stock.

(ii) *Result.* Under paragraph (b)(3)(ii) of this section, $100 of accumulated earnings and profits of CFC is attributable to the stock of CFC sold by DC2, even though DC2 did not hold the stock of CFC during the time CFC accumulated the earnings and profits.

Example 4. Acquisition of a controlled foreign corporation by a controlled foreign corporation in a reorganization described in section 368(a)(1)(C) (or section 368(a)(1)(B)). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. DC2, a domestic corporation unrelated to DC1, has owned all of the stock of CFC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that is a reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets to CFC2 in exchange for 25% of the voting stock of CFC2. CFC1 distributes the CFC2 stock to DC1 and the CFC1 stock is cancelled. DC1's holding period in the CFC2 stock, determined under section 1223(1), begins on January 1, year 1. On December 31, year 3, CFC1 has $100 of accumulated earnings and profits and CFC2 has $200 of accumulated earnings and profits. CFC2 succeeds to the $100 of CFC1 accumulated earnings and profits in the reorganization under section 381. From January 1, year 4 to December 31, year 5, CFC2 incurred a deficit in earnings and profits in the amount of ($200). On December 31, year 5, both DC1 and DC2 sell their stock in CFC2.

(ii) *Result.* (A) *DC1.* Pursuant to paragraph (b)(2)(ii) of this section, $50 of earnings and profits is attributable to the CFC2 stock sold by DC1. This amount consists of $100 of CFC1's earnings and profits accumulated before the restructuring transaction, reduced by 25% of CFC2's ($200) post-restructuring transaction deficit in earnings and profits. None of the $200 of CFC2's earnings and profits accumulated by CFC2 prior to the reorganization is attributed to the CFC2 stock sold by DC1. Also, none of the earnings and profits CFC2 succeeded to under section 381 is attributed to the CFC2 stock sold by DC1, pursuant to paragraph (b)(6) of this section.

(B) *DC2.* Pursuant to paragraph (b)(4) of this section, there is $50 of accumulated earnings and profits attributable to the CFC2 stock sold by DC2. This amount consists of all of the $200 of CFC2's earnings and profits accumulated by CFC2 prior to the reorganization, reduced by 75% of CFC2's deficit in earnings and profits in the amount of ($200) incurred after the restructuring transaction. None of the $100 of CFC1 accumulated earnings and profits succeeded to under section 381 is attributable to the CFC2 stock sold by DC2, pursuant to paragraph (b)(6) of this section.

(C) *Section 368(a)(1)(B) reorganization.* If, instead of DC1 acquiring its 25% interest in CFC2 pursuant to a reorganization described in section 368(a)(1)(C), DC1 had transferred the stock of CFC1 to CFC2 in exchange for 25% of the voting stock of CFC2 in a reorganization described in section 368(a)(1)(B), the results would be the same as described in paragraphs (ii)(A) and (B) of this *Example 4.*

Example 5. Acquisition of the stock of a foreign corporation that controls a domestic acquiring corporation in a triangular reorganization described in section 368(a)(1)(C). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of DC2, a domestic corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to DC2 in exchange for 60% of the voting stock of FC. CFC1 transfers the voting stock of FC to DC1 and the CFC1 stock is cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), DC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits, CFC2 has $300 of earnings and profits, and FC has $200 of earnings and profits. DC1 includes the $100 all earnings and profits amount attributable to its CFC1 stock in income as a deemed dividend under §1.367(b)–3 upon the exchange of CFC1 stock for FC stock. Pursuant to the lower-tier earnings exclusion of §1.367(b)–2(d)(3)(ii), that amount does not include the $300 of earnings and profits of CFC2. From January 1, year 4, until December 31, year 5, FC (now a controlled foreign corporation) accumulates an additional $50 of earnings and profits. From January 1, year 4 until December 31, year 5, CFC2 accumulates an additional $100 of earnings and profits. On December 31, year 5, DC1 sells its stock in FC and DC2 sells its stock in CFC2.

(ii) *Result.* (A) *DC1.* Pursuant to paragraph (b)(2)(iii) of this section, there is $30 of earnings and profits attributable to the stock of FC sold by DC1. This amount consists of 60% of the $50 of earnings and profits accumulated by FC after the restructuring transaction, and none of the earnings and profits accumulated by CFC1, CFC2, or FC before the restructuring transaction.

(B) *DC2.* Pursuant to paragraph (b)(3)(ii) of this section, there is $400 of earnings and profits attributable to the stock of CFC2 sold by DC2. This amount consists of all of the earnings and profits accumulated by CFC2 during DC2's section 1223(2) holding period.

Example 6. Acquisition of the stock of a foreign corporation that controls a foreign acquiring corporation in a reorganization described in section 368(a)(1)(C). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of FC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to FC2 in exchange for 60% of the voting stock of FC. CFC1 transfers the voting stock of FC to DC1 and the CFC1 stock is cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), FC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits, CFC2 has $300 of earnings and profits, FC has $200 of earnings and profits, and FC2 has no earnings and profits. From January 1, year 4, until December 31, year 5, FC (now a controlled foreign corporation) accumulates an additional $50 of earnings and profits. From January 1, year 4 until December 31, year 5, CFC2 accumulates an additional $100 of earnings and profits. FC2, a controlled foreign corporation after the restructuring transaction, accumulates $100 of earnings and profits from January 1, year 4, until December 31, year 5. On December 31, year 5, DC1 sells its stock in FC.

(ii) *Result.* Pursuant to paragraphs (b)(2)(ii) and (b)(4)(iii) of this section, there is $550 of earnings and profits attributable to the stock of FC sold by DC1. This amount consists of all $400 of the CFC1 and CFC2 earnings and profits accumulated before the restructuring transaction (see also section 1248(c)(2)), and 60% of the $250 of the earnings and profits accumulated by FC, FC2, and CFC2 after the restructuring transaction.

Example 7. Acquisition of controlled foreign corporation stock by a controlled foreign corporation in a reorganization described in section 368(a)(1)(B), followed by a sale of the acquired stock by the acquiring controlled foreign corporation. (i) *Facts.* DC1, a domestic corporation, has owned all of the outstanding stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all of the outstanding stock of CFC3, a foreign corporation, since its formation on January 1, year 1. DC2, a domestic corporation unrelated to DC1, has owned all of the outstanding stock of CFC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that is a reorganization described in section 368(a)(1)(B), CFC1 transfers all of the stock of CFC3 to CFC2 in exchange for 40% of CFC2's stock. On December 31, year 3, CFC2 and CFC3 have, re-

spectively, $40 and $20 of earnings and profits. On December 31, year 5, when the accumulated earnings and profits of CFC3 are $50 ($20 of earnings and profits as of December 31, year 3, plus $30 of earnings and profits generated from January 1, year 4, through December 31, year 5), CFC2 sells the stock of CFC3 in a transaction to which section 964(e) applies.

(ii) *Result*. (A) *CFC2*. Pursuant to paragraph (b)(3)(ii) of this section, there is $50 of earnings and profits attributable to the CFC3 stock sold by CFC2. This amount consists of the accumulated earnings and profits attributable to CFC2's entire section 1223(2) holding period in the CFC3 stock.

(B) *CFC1, DC2, and DC1*. Under paragraph (b)(5) of this section, the earnings and profits attributable to the CFC2 stock held by CFC1 and DC2, and the earnings and profits attributable to the CFC1 stock held by DC1, will be reduced (regardless of whether CFC2 recognizes gain on its sale of CFC3 stock).

(*1*) *CFC1*. The earnings and profits attributable to the CFC2 stock held by CFC1 will be reduced by $32, or the amount of earnings and profits as of December 31, year 5, that would have been attributable to the CFC2 stock held by CFC1 pursuant to paragraph (b)(2)(ii) of this section. This amount consists of all of the $20 of earnings and profits accumulated by CFC3 before the restructuring transaction and 40% of the $30 of earnings and profits accumulated by CFC3 after the restructuring transaction (.40 X $30 = $12).

(*2*) *DC1*. The earnings and profits attributable to the CFC1 stock held by DC1 will also be reduced by $32, or the amount of earnings and profits that would have been attributable to the CFC1 stock held by DC1 as of December 31, year 5.

(*3*) *DC2*. The earnings and profits attributable to the CFC2 stock held by DC2 will be reduced by $18, or the amount of earnings and profits that would have been attributable to the CFC2 stock held by DC2 as of December 31, year 5, under paragraph (b)(4) of this section. This amount consists of 60% of the $30 (.60 X $30 = $18) of earnings and profits accumulated by CFC3 after the restructuring transaction.

(C) *Partial sale by CFC2*. If, instead of selling 100% of the CFC3 stock, on December 31, year 5, CFC2 sells only 50% of its CFC3 stock, paragraph (b)(5) of this section requires CFC1 to reduce the earnings and profits of CFC3 attributable to its CFC2 stock to $16. Similarly, DC1 would be required to reduce the earnings and profits of CFC3 attributable to its CFC1 stock by $16. Paragraph (b)(5) of this section also requires DC2 to reduce the CFC3 earnings and profits attributable to its CFC2 stock by $9. These reductions occur without regard to whether CFC2 recognizes gain on its sale of CFC3 stock.

Example 8. Acquisition of the assets of a lower-tier controlled foreign corporation by an upper-tier controlled foreign corporation in a restructuring transaction described in section 368(a)(1)(C). (i) *Facts*. DC, a domestic corporation, has owned all the stock of CFC1, a controlled foreign corporation, since its formation on January 1, year 1. CFC1 is a holding company that has owned 79% of the stock of CFC2, a controlled foreign corporation, since its formation on January 1, year 1. The other 21% of CFC2 stock is owned by X, an unrelated party. On December 31, year 1, CFC2 has $200 of earnings and profits. On December 31, year 1, CFC1 has no accumulated earnings and profits. On December 31, year 1, pursuant to a restructuring transaction described in section 368(a)(1)(C), CFC2 transfers all its properties to CFC1. In exchange, CFC1 assumes the liabilities of CFC2 and transfers to CFC2 voting stock representing 21% of the stock of CFC1. CFC2 distributes the voting stock to X and liquidates. The liabilities assumed do not exceed 20% of the value of the properties of CFC2. From January 1, year 2, to December 31, year 3, CFC1 accumulates $100 of earnings and profits. On December 31, year 3, DC sells its CFC1 stock.

(ii) *Result*. Pursuant to paragraph (b)(4)(ii) of this section, there is $237 of earnings and profits attributable to DC's CFC1 stock. This amount consists of 79% of CFC2's $200 of earnings and profits accumulated before the restructuring transaction (see section 1248(c)(2)), and 79% of CFC1's $100 of earnings and profits accumulated after the restructuring transaction. Pursuant to paragraph (b)(6) of this section, none of CFC2's $200 of earnings and profits to which CFC1 succeeded under section 381 would be attributable to DC's CFC1 stock.

(c) *Earnings and profits attributable to stock of a foreign distributee corporation that is a foreign corporate shareholder with respect to a foreign liquidating corporation*—(1) *General rule*. If a foreign corporation (liquidating corporation) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (distributee), and immediately before the liquidation the distributee was a foreign corporate shareholder with respect to the liquidating foreign corporation, the amount of earnings and profits attributable to the distributee stock upon its subsequent sale or exchange will be determined under this paragraph (c)(1). The earnings and profits attributable will be the sum of the earnings and profits attributable to the stock of the distributee immediately before the liquidation (including amounts attributed under section 1248(c)(2)) and the earnings and profits attributable to the stock of the distributee accumulated after the liquidation (including amounts attributed under section 1248(c)(2)).

(2) *Special rule regarding section 381*. Solely for purposes of determining the earnings and profits (or deficit in earnings and profits) attributable to stock under this paragraph (c), the attributed earnings and profits of a corporation shall not include earnings and profits that are treated as received or incurred pursuant to section 381(c)(2)(A) and §1.381(c)(2)–1(a).

(3) *Example*. (i) *Facts*. DC, a domestic corporation, has owned all of the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 is an operating company that has owned all of the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. On December 31, year 2, CFC1 has $200 of accumulated earnings and profits and CFC2 has a ($200) deficit in earnings and profits. On December 31, year 2, CFC2 distributes all of its assets and liabilities to CFC1 in a liquidation to which section 332 applies. From January 1, year 3, until December 31, year 4, CFC1 accumulates no additional earnings and profits. On December 31, year 4, DC sells its stock in CFC1.

(ii) *Result*. Pursuant to paragraph (c)(1) of this section, there are no earnings and profits attributable to DC's CFC1 stock. This amount consists of the sum of the earnings and profits attributable to the CFC1 stock immediately before the liquidation (100% of the $200 accumulated earnings and profits of CFC1 and 100% of CFC2's ($200) deficit in earnings and profits) and the amount of earnings and profits accumulated after the section 332 liquidation (see also section 1248(c)(2)).

(d) *Effective/applicability date*. This section applies to income inclusions that occur on or after July 30, 2007.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 16, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 27, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 30, 2007, 72 F.R. 41442)

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for September 2007.

Rev. Rul. 2007–57

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term

adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2007–57 TABLE 1

Applicable Federal Rates (AFR) for September 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.82%	4.76%	4.73%	4.71%
110% AFR	5.31%	5.24%	5.21%	5.18%
120% AFR	5.79%	5.71%	5.67%	5.64%
130% AFR	6.29%	6.19%	6.14%	6.11%
Mid-term				
AFR	4.79%	4.73%	4.70%	4.68%
110% AFR	5.27%	5.20%	5.17%	5.14%
120% AFR	5.76%	5.68%	5.64%	5.61%
130% AFR	6.24%	6.15%	6.10%	6.07%
150% AFR	7.23%	7.10%	7.04%	7.00%
175% AFR	8.45%	8.28%	8.20%	8.14%
Long-term				
AFR	5.09%	5.03%	5.00%	4.98%
110% AFR	5.61%	5.53%	5.49%	5.47%
120% AFR	6.13%	6.04%	6.00%	5.97%
130% AFR	6.65%	6.54%	6.49%	6.45%

REV. RUL. 2007–57 TABLE 2

Adjusted AFR for September 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.65%	3.62%	3.60%	3.59%
Mid-term adjusted AFR	3.92%	3.88%	3.86%	3.85%
Long-term adjusted AFR	4.44%	4.39%	4.37%	4.35%

REV. RUL. 2007–57 TABLE 3

Rates Under Section 382 for September 2007

Adjusted federal long-term rate for the current month	4.44%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.50%

REV. RUL. 2007–57 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for September 2007	
Appropriate percentage for the 70% present value low-income housing credit	8.15%
Appropriate percentage for the 30% present value low-income housing credit	3.49%

REV. RUL. 2007–57 TABLE 5	
Rate Under Section 7520 for September 2007	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.8%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 1502.—Regulations

26 CFR 1.1502–77: Agent for the group.

T.D. 9343

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Agent for a Consolidated Group With Foreign Common Parent

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 1502 that provide the Internal Revenue Service with the authority to designate a domestic member of the consolidated group as a substitute agent to act as the sole agent for the group where a foreign entity is the group's common parent. The final regulations are necessary to clarify and explain the rules governing the designation of an agent for the members of a consolidated group. The regulations affect corporations that join in the filing of a consolidated Federal income tax return where the common parent of the consolidated group is a foreign entity that is treated as a domestic corporation pursuant to section 7874(b) of the Internal Revenue Code (Code) or as the result of a section 953(d) election.

DATES: *Effective Date:* These regulations are effective July 23, 2007.

Applicability Date: For dates of applicability, see §1.1502–77(h)(3).

FOR FURTHER INFORMATION CONTACT: Stephen R. Cleary, (202) 622–7750, (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 14, 2006, the IRS and Treasury Department published temporary regulations (T.D. 9255, 2006–1 C.B. 741) in the **Federal Register** (71 FR 13001) providing the IRS the authority to designate a domestic member of a consolidated group to be the sole agent for the group where the common parent of the group is a foreign entity. A notice of proposed rule- making (REG–164247–05, 2006–1 C.B. 758) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (71 FR 13062). The temporary regulations provide procedures for the IRS's designation of a "domestic substitute agent" and define the term of that substitute agent's agency.

Explanation of Provisions and Summary of Comments

No comments were received responding to the notice of proposed rulemaking, and no public hearing was requested or held. The proposed regulations are adopted as amended by this Treasury decision and the corresponding temporary regulations are removed. The temporary regulations, as contained in the 26 CFR part 1 edition revised as of April 1, 2007, remain in effect for certain taxable years as provided by §1.1502–77(h)(3)(ii) of these final regulations.

These final regulations clarify the term of the domestic substitute agent's agency by specifying that once appointed for one or more taxable years of the group, unless the designation is expressly limited to such term, the domestic substitute agent will continue to be the agent for subsequent taxable years of the group until certain specified events occur. These final regulations also specify that, if the domestic substitute agent is the group's agent for a taxable year, it will generally continue to serve as the agent for that year until the domestic substitute agent's existence terminates. Finally, these final regulations clarify that if a group with a domestic substitute agent continues in existence with a new common parent that is a domestic corporation (without regard to section 7874 or a section 953(d) election) during a consolidated return year, the domestic substitute agent is the agent of the group for the year through the date of the transaction in which the new common parent becomes the common parent, and thereafter the new common parent becomes the agent of the group for the entire taxable year.

Additionally, these regulations indicate that §1.1502–77(e)(1) is also applicable for purposes of determining whether a domestic substitute agent's existence has terminated.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to 5 U.S.C. 553(d)(3) it has been determined that a delayed effective date is unnecessary because this rule finalizes currently effective temporary rules regarding the designation of a domestic substitute agent without substantive change. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Stephen R. Cleary of the Office of Associate Chief Counsel (Corporate). Other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.1502–77T to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1502–77 is amended by:

1. Revising paragraph (e)(1).
2. Adding paragraph (h)(3).
3. Revising paragraph (j).

The additions and revisions read as follows:

§1.1502–77 Agent for the group.

* * * * *

(e) *Termination of a corporation's existence*—(1) *In general.* For purposes of paragraphs (a)(1)(v), (a)(4)(i), (d), and (j) of this section, the existence of a corporation is deemed to terminate if—

(i) Its existence terminates under applicable law; or

(ii) Except as provided in paragraph (e)(3) of this section, it becomes, for Federal tax purposes, either—

(A) an entity that is disregarded as an entity separate from its owner; or

(B) an entity that is reclassified as a partnership. * * *

* * * * *

(h) * * *

(3) *Designation of a domestic substitute agent*—(i) *In general.* The provisions of paragraphs (e)(1) and (j) of this section apply to taxable years for which the consolidated Federal income tax return is due (without extensions) after July 23, 2007.

(ii) *Prior law.* For taxable years for which the consolidated Federal income tax return is due (without extensions) on or before July 23, 2007, see §1.1502–77(e)(1) as contained in the 26 CFR part 1 edition revised as of April 1, 2007. For taxable years for which the consolidated Federal income tax return is due (without extensions) after March 14, 2006, and on or before July 23, 2007, see §1.1502–77T as contained in the 26 CFR part 1 edition revised as of April 1, 2007.

* * * * *

(j) *Designation by Commissioner if common parent is treated as a domestic corporation under section 7874 or section 953(d)*—(1) *In general.* If the common parent is an entity created or organized under the law of a foreign country and is treated as a domestic corporation by reason of section 7874 (or regulations under that section) or a section 953(d) election (a foreign common parent), the Commissioner may at any time, with or without a request from any member of the group, designate another member of the group to act as the agent for the group (a domestic substitute agent) for any taxable year for which the consolidated Federal income tax return is due (without extensions) after July 23, 2007, and the foreign common parent would otherwise be the agent for the group. For each such year, the domestic substitute agent will be the sole agent for the group even though the foreign common parent remains in existence. The foreign common parent ceases to be the agent for the group when the Commissioner's designation of a domestic substitute agent becomes effective. The Commissioner may designate a domestic substitute agent for the term of a single taxable year, multiple years, or on a continuing basis.

(2) *Domestic substitute agent.* The domestic substitute agent, by designation or by succession, shall be a domestic corporation described in paragraph (d)(1)(i)(A) of this section (determined without regard to section 7874, a section 953(d) election or section 1504(d)).

(3) *Designation by the Commissioner.* The Commissioner will notify the domestic substitute agent in writing by mail or faxed transmission of the designation. The domestic substitute agent's designation is effective on the earliest of the 14th day following the date of a mailing, the 4th day following a faxed transmission, or the date the Commissioner receives written confirmation of the designation by a duly authorized officer of the domestic substitute agent (within the meaning of section 6062). The domestic substitute agent must give notice of its designation to the foreign common parent and each corporation that was a member of the group during any part of any consolidated return year for which the domestic substitute agent will be the agent. A failure of the domestic substitute agent to notify the foreign common parent or any member of the group does not invalidate the designation. The Commissioner will send a copy of the notification to the foreign common parent, and if applicable, to any domestic substitute agent the designation replaces; a failure to send a copy of the notification does not invalidate the designation.

(4) *Term of agency*—(i) *Taxable years for which domestic substitute agent is the agent.* If the Commissioner designates a domestic substitute agent for one or more taxable years, unless the designation is expressly limited to such term, such domestic substitute agent will continue as the group's sole agent for subsequent taxable years until the domestic substitute agent ceases to be a member of the continuing group, is replaced by a new domes-

tic common parent (as provided in paragraph (j)(4)(iv)(A) of this section), is replaced by the Commissioner, or is replaced by a default substitute agent (as provided in paragraph (j)(5)(ii) of this section). If during the course of a consolidated return year the domestic substitute agent ceases to be a member of the continuing group or is replaced, it shall no longer act as agent for such taxable year or subsequent taxable years in any matter.

(ii) *Continuing agency for prior taxable years.* Unless replaced by a default substitute agent (as provided in paragraph (j)(5)(ii) of this section) or by the Commissioner, the domestic substitute agent at the end of a taxable year of the group will remain the agent for such year until its existence terminates, even if the group subsequently ceases to exist or the domestic substitute agent subsequently ceases to be a member of the group.

(iii) *Replacement of a §1.1502–77(d)(1) agent.* If, pursuant to paragraph (d)(1) of this section, the common parent of the group designates a foreign common parent as the agent for the group for any taxable year, the Commissioner may, at any time, designate a domestic substitute agent to replace the foreign common parent, even if the Commissioner approved the terminating common parent's designation.

(iv) *Group continues with a new common parent*—(A) *Year the new common parent becomes the common parent.* If the group has a domestic substitute agent and the group continues in existence with a new common parent during a consolidated return year, and such new common parent is a domestic corporation (determined without regard to section 7874 or a section 953(d) election), the domestic substitute agent at the beginning of the year is the agent for the group through the date of the transaction in which the new common parent becomes the common parent, and the new common parent becomes the agent for the group beginning the day after the transaction, at which time it becomes the agent for the group with respect to the entire consolidated return year (including the period through the date of the transaction) and the former domestic substitute agent will no longer be the agent for the group for that year.

(B) *Years preceding the year the new common parent becomes the common parent.* If after the Commissioner's designation of a domestic substitute agent the group remains in existence with a new common parent, and such new common parent is a domestic corporation (determined without regard to section 7874 or a section 953(d) election), the Commissioner may designate the new common parent as the sole agent for the group for any of the group's prior taxable years (for which the consolidated Federal income tax return is due (without extensions) after July 23, 2007) in which the new common parent was a member of the group. For this purpose, the new common parent is treated as having been a member of the group for any taxable year it is primarily liable for the group's income tax liability.

(v) *Replacement of domestic substitute agent by the Commissioner.* The Commissioner may at any time, with or without a request from any member of the group, designate a replacement for a domestic substitute agent (or a successor to such agent).

(5) *Deemed §1.1502–77(d) designation*—(i) *In general.* If the Commissioner designates a domestic substitute agent under this paragraph (j), it will be treated as a designation of a substitute agent under paragraph (d) of this section.

(ii) *Default substitute agent.* If the domestic substitute agent's existence terminates and it has a single successor that is a domestic corporation (without regard to section 269B) that is eligible to be a domestic substitute agent, such successor becomes the domestic substitute agent and is treated as a default substitute agent under paragraph (d)(2) of this section. See paragraph (d)(4) of this section regarding the consequences of the successor's failure to notify the Commissioner of its status as a default substitute agent. The default substitute agent shall use procedures in section 9 of Rev. Proc. 2002–43, 2002–2 C.B. 99, or a corresponding provision of a successor revenue procedure for notification. (See §601.601(d)(2)(ii)(*b*) of this chapter.)

(6) *Request that IRS designate a domestic substitute agent*—(i) *Original designation.* If the common parent of the group is a foreign common parent, and the IRS has not designated a domestic substitute agent, one or more members of the group may request the IRS to make a designation for taxable years for which the consolidated Federal income tax return is due (without extensions) after July 23, 2007. Such request is deemed to be a request under paragraph (d)(3)(i) of this section. Members of the group shall use the procedures in section 10 of Rev. Proc. 2002–43, 2002–2 C.B. 99, or a corresponding provision of a successor revenue procedure for this purpose. (See §601.601(d)(2)(ii)(*b*) of this chapter.)

(ii) *Request that IRS replace a previously designated substitute agent.* If the IRS designates a domestic substitute agent pursuant to this paragraph (j), one or more members of the group may request that the IRS replace the designated domestic substitute agent with another member (or successor to another member). Such a request is deemed to be a request pursuant to paragraph (d)(3)(ii) of this section. Members of the group shall use the procedures in section 11 of Rev. Proc. 2002–43, 2002–2 C.B. 99, or a corresponding provision of a successor revenue procedure for this purpose. (See §601.601(d)(2)(ii)(*b*) of this chapter.)

§1.1502–77T [Removed]

Par. 3. Section 1.1502–77T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 16, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 23, 2007, 72 F.R. 40066)

Section 7425.—Discharge of Liens

26 CFR 301.7425–3: Discharge of liens; special rules.

T.D. 9344

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Change to Office to Which Notices of Nonjudicial Sale

and Requests for Return of Wrongfully Levied Property Must Be Sent

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the discharge of liens under section 7425 and return of wrongfully levied upon property under section 6343 of the Internal Revenue Code (Code) of 1986. These temporary regulations clarify that such notices and claims should be sent to the IRS official and office specified in the relevant IRS publications. The temporary regulations will affect parties seeking to provide the IRS with notice of a nonjudicial foreclosure sale and parties making administrative requests for return of wrongfully levied property. The text of the temporary regulations also serves as the text of the proposed regulation (REG–148951–05) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective/applicability Date:* These regulations are effective **August 20, 2007**.

FOR FURTHER INFORMATION CONTACT: Robin M. Ferguson, (202) 622–3630 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to the giving of notice of nonjudicial sales under section 7425(b) of the Code. Final regulations (T.D. 7430, 1976–2 C.B. 314) were published on August 20, 1976, in the **Federal Register** (41 FR 35174). This document also contains amendments to the Procedure and Administration Regulations relating to requests for return of wrongfully levied property under section 6343(b) of the Code. Final regulations (T.D. 8587, 1995–1 C.B. 207) were published on January 3, 1995, in the **Federal Register** (60 FR 33).

For notices of nonjudicial foreclosure sale under Section 7425(b) and requests for return of property wrongfully levied upon under Section 6343(b), the existing regulations direct the notices and requests to be sent to the "district director (marked for the attention of the Chief, Special Procedures Staff)." The offices of the district director and Special Procedures were eliminated by the IRS reorganization implemented pursuant to the IRS Restructuring and Reform Act of 1998, Public Law 105–206 (RRA 1998), creating uncertainty as to the timeliness of notices and requests under these provisions.

Explanation of Provisions

Section 7425(b) provides for the discharge of a junior federal tax lien by a nonjudicial sale, if proper notice is provided to the IRS. Treas. Reg. §301.7425–2(a). Notice of a nonjudicial sale is required if notice of the federal tax lien has been properly filed more than 30 days before the nonjudicial sale. Section 7425(b)(1). A party holding a nonjudicial sale must provide written notification to the IRS at least 25 days prior to the scheduled sale of the property or the federal tax lien remains on the property after the sale. Section 7425(c)(1). When the notice is properly sent, and the federal tax lien discharged, the IRS may redeem the property within 120 days from the date of sale or any longer period allowed under state law. Section 7425(d). If the notice is not properly sent, the nonjudicial sale is made subject to and without disturbing the federal tax lien. Section 7425(b); Treas. Reg. §301.7425–2(a); *Tompkins v. United States*, 946 F.2d 817, 820 (11th Cir. 1991); *Simon v. United States*, 756 F.2d 696, 697–98 (9th Cir. 1985).

Treas. Reg. §301.7425–3(a)(1) specifies that notice "shall be given, in writing by registered or certified mail or by personal service … to the district director (marked for the attention of the chief, special procedures staff) for the Internal Revenue district in which the sale is to be conducted." The regulation further provides that such notice of sale is not effective if given to a district director other than the district director for the Internal Revenue district in which the sale is to be conducted.

In light of the IRS reorganization subsequent to RRA 1998, the district and special procedures offices referenced in the regulations no longer exist. Notices of sale, if addressed to an office other than that stated in the regulation, may be misdirected. As a result, the IRS office responsible for evaluating notices of nonjudicial sale may not receive notice of the sale and the IRS may not have the opportunity to timely redeem. In *Glasgow Realty, LLC v. Withington*, 345 F.Supp. 2d 1025 (E.D. Mo. 2004), the court held that the federal tax lien was discharged by a nonjudicial sale under section 7425(b) where the notice of sale was addressed to a local IRS taxpayer assistance center rather than the district director's office. *Glasgow Realty* demonstrates the confusion that resulted from attempts to comply with the current regulation in light of the IRS reorganization. An amendment is necessary to both assist the public so as to prevent further confusion on where to send notices of nonjudicial foreclosure sales, and to prevent the possible loss of proceeds that the IRS could acquire from redemptions if the proper office has timely notice of the sale.

Similar problems arise with respect to requests for return of wrongfully levied property under section 6343(b). Requests for the return of the amount of money levied upon or received from the sale of property must be filed within nine months from the date of the levy. Treas. Reg. §301.6343–2(a)(2). The nine month period for filing a wrongful levy suit is extended by the filing of a timely administrative claim. Section 6532(c).

As is the case with notices of nonjudicial sale, the regulations specify that the request for return of wrongfully levied property be addressed to the district director (marked for the attention of the Chief, Special Procedures Staff) for the Internal Revenue district in which the levy is made. Treas. Reg. §301.6343–2(b). The elimination of these offices by the IRS reorganization can similarly result in misdirected requests. An amendment is necessary to assist the public in filing timely requests with the proper office.

In order to account for the IRS's current organizational structure and to allow for future reorganizations of the IRS, the temporary regulations remove the title "district director" throughout Treas. Reg. §§301.7425–3 and 301.6343–2. The title is not replaced with any specific official or office. Instead, the public is directed

to refer to the current relevant IRS publications or their successor publications for where to send notices or claims. The temporary regulations provide the web address for the IRS Internet site which may be used to obtain copies of IRS publications. The current publications for nonjudicial foreclosure sales are IRS Publication 786, "*Instructions for Preparing a Notice of Nonjudicial Sale of Property and Application for Consent to Sale*," and IRS Publication 4235, "*Technical Services (Advisory) Group Addresses*." According to Publication 786, the application or notice should be addressed to the Technical Services Group Manager for the area in which the notice of federal tax lien was filed. Publication 786 then instructs the reader to use Publication 4235 to determine where to mail the request. Publication 4235 lists the addresses for the Technical Services offices. The current publication for requests for return of wrongfully levied property is IRS Publication 4528, "*Making an Administrative Wrongful Levy Claim Under Internal Revenue Code (IRC) Section 6343(b)*." According to Publication 4528, the claim should be marked for the attention of the Advisory Territory Manager for the area where the taxpayer whose tax liability was the basis for the levy or seizure resides. Publication 4528 then instructs the reader to use Publication 4235 to locate the mailing address for the appropriate Advisory Territory Manager.

Effective Date

These temporary regulations apply to any notice of sale filed or request for return of property made after **August 20, 2007**.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Robin M. Ferguson, Office of Associate Chief Counsel, Procedure and Administration Division.

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Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6343–2 is amended as follows:

1. Paragraphs (a)(1) introductory text and (b) introductory text are revised.

2. Paragraphs (a)(4), (c), (d)(1), and (d)(2) are amended by removing the language "director" and adding the language "IRS" in its place wherever it appears.

3. Paragraph (b)(4), is amended by removing the language "Internal Revenue district" and adding the language "IRS office" in its place.

4. Paragraph (e) is revised.

The revisions and addition read as follows:

§301.6343–2 Return of wrongfully levied upon property.

(a) * * * (1) [Reserved]. For further guidance, see §301.6343–2T(a) introductory text.

* * * * *

(b) [Reserved]. For further guidance, see §301.6343–2T(b) introductory text.

* * * * *

(e) [Reserved]. For further guidance, see §301.6343–2T(e).

Par. 3. Section 301.6343–2T is added to read as follows:

§301.6343–2T Return of wrongfully levied upon property.

(a) *Return of property*— (1) *General rule*. If the Internal Revenue Service (IRS) determines that property has been wrongfully levied upon, the IRS may return—

(a)(1)(i) through (a)(4) [Reserved]. For further guidance, see §301.6343–2(a)(1)(i) through (a)(4).

(b) *Request for return of property.* A written request for the return of property wrongfully levied upon must be given to the IRS official, office and address specified in IRS Publication 4528, "*Making an Administrative Wrongful Levy Claim Under Internal Revenue Code (IRC) Section 6343(b)*," or its successor publication. The relevant IRS publications may be downloaded from the IRS internet site at *www.irs.gov*. Under this section, a request for the return of property wrongfully levied upon is not effective if it is given to an office other than the office listed in the relevant publication. The written request must contain the following information—

(b)(1) through (d)(2) [Reserved]. For further guidance, see §301.6343–2(b)(1) through (d)(2).

(e) *Effective/applicability date.* This section applies to any request for return of wrongfully levied property that is filed after **August 20, 2007.**

Par. 4. Section 301.7425–3 is amended as follows:

1. Paragraphs (a)(1), (b)(1), (b)(2), (c)(1), (d)(2), (d)(3), and (d)(4) are revised.

2. Paragraphs (a)(2)(i), (a)(2)(ii)(C), and (a)(2)(iii) *Examples 1*, *2*, and *3* are amended by removing the language "district director" and adding the language "IRS" in its place wherever it appears.

3. Paragraph (d)(1)(ii)(A) is amended by removing the language "internal revenue district" and adding the language "IRS office" in its place.

4. Paragraph (e) is added.

The revisions and addition read as follows:

§301.7425–3 Discharge of liens; special rules.

(a) * * * (1) [Reserved]. For further guidance, see §301.7425–3T(a)(1).

* * * * *

(b) * * * (1) [Reserved]. For further guidance, see §301.7425–3T(b)(1).

* * * * *

(2) [Reserved]. For further guidance, see §301.7425–3T(b)(2).

(c) * * * (1) [Reserved]. For further guidance, see §301.7425–3T(c)(1).

* * * * *

(d) * * *

(2) [Reserved]. For further guidance, see §301.7425–3T(d)(2).

(3) [Reserved]. For further guidance, see §301.7425–3T(d)(3).

(4) [Reserved]. For further guidance, see §301.7425–3T(d)(4).

(e) [Reserved]. For further guidance, see §301.7425–3T(e).

Par. 5. Section 301.7425–3T is added to read as follows:

§301.7425–3T Discharge of liens; special rules.

(a) *Notice of sale requirements*—(1) *In general.* Except in the case of the sale of perishable goods described in paragraph (c) of this section, a notice (as described in paragraph (d) of this section) of a nonjudicial sale shall be given, in writing by registered or certified mail or by personal service, not less than 25 days prior to the date of sale (determined under the provisions of §301.7425–2(b)), to the Internal Revenue Service (IRS) official, office and address specified in IRS Publication 786, "*Instructions for Preparing a Notice of Nonjudicial Sale of Property and Application for Consent to Sale*," or its successor publication. The relevant IRS publications may be downloaded from the IRS internet site at *www.irs.gov*. Under this section, a notice of sale is not effective if it is given to an office other than the office listed in the relevant publication. The provisions of sections 7502 (relating to timely mailing treated as timely filing) and 7503 (relating to time for performance of acts where the last day falls on Saturday, Sunday, or a legal holiday) apply in the case of notices required to be made under this paragraph.

(a)(2) [Reserved]. For further guidance, see §301.7425–3(a)(2).

(b) *Consent to sale*—(1) *In general.* Notwithstanding the notice of sale provisions of paragraph (a) of this section, a nonjudicial sale of property shall discharge or divest the property of the lien and title of the United States if the IRS consents to the sale of the property free of the lien or title. Pursuant to section 7425(c)(2), where adequate protection is afforded the lien or title of the United States, the IRS may, in its discretion, consent with respect to the sale of property in appropriate cases. Such consent shall be effective only if given in writing and shall be subject to such limitations and conditions as the IRS may require. However, the IRS may not consent to a sale of property under this section after the date of sale, as determined under §301.7425–2(b). For provisions relating to the authority of the IRS to release a lien or discharge property subject to a tax lien, see section 6325 and the section 6325 regulations.

(2) *Application for consent.* Any person desiring the IRS's consent to sell property free of a tax lien or a title derived from the enforcement of a tax lien of the United States in the property shall submit to the IRS, at the office and address specified in the relevant IRS publications, a written application, in triplicate, declaring that it is made under penalties of perjury, and requesting that such consent be given. The application shall contain the information required in the case of a notice of sale, as set forth in paragraph (d)(1) of this section, and, in addition, shall contain a statement of the reasons why the consent is desired.

(c) *Sale of perishable good*–(1) *In general.* A notice (as described in paragraph (d) of this section) of a nonjudicial sale of perishable goods (as defined in paragraph (c)(2) of this section) shall be given in writing, by registered or certified mail or delivered by personal service, at any time before the sale, to the IRS official and office specified in the relevant IRS publications, at the address specified in such publications. Under this section, a notice of sale is not effective if it is given to an office other than the office listed in the relevant publication. If a notice of a nonjudicial sale is timely given in the manner described in this paragraph, the nonjudicial sale shall discharge or divest the tax lien, or a title derived from the enforcement of a tax lien, of the United States in the property. The provisions of sections 7502 (relating to timely mailing treated as timely filing) and 7503 (relating to time for performance of acts where the last day falls on Saturday, Sunday, or a legal holiday) apply in the case of notices required to be made under this paragraph. The seller of the perishable goods shall hold the proceeds (exclusive of costs) of the sale as a fund, for not less than 30 days after the date of the sale, subject to the liens and claims of the United States, in the same manner and with the same priority as the liens and claims of the United States had with respect to the property sold. If the seller fails to hold the proceeds of the sale in accordance with the provisions of this paragraph and if the IRS asserts a claim to the proceeds within 30 days after the date of sale, the seller shall be personally liable to the United States for an amount equal to the value of the interest of the United States in the fund. However, even if the proceeds of the sale are not so held by the seller, but all the other provisions of this paragraph are satisfied, the buyer of the property at the sale takes the property free of the liens and claims of the United States. In the event of a postponement of the scheduled sale of perishable goods, the seller is not required to notify the IRS of the postponement. For provisions relating to the authority of the IRS to release a lien or discharge property subject to a tax lien, see section 6325 and the regulations.

(c)(2) through (d)(1) [Reserved]. For further guidance, see §301.7425–3(c)(2) through (d)(1).

(d)(2) *Inadequate notice.* Except as otherwise provided in this paragraph, a notice of sale described in paragraph (a) of this section which does not contain the information described in paragraph (d)(1) of this section shall be considered inadequate by the IRS. If the IRS determines that the notice is inadequate, the IRS will give written notification of the items of information which are inadequate to the person who submitted the notice. A notice of sale which does not contain the name and address of the person submitting such notice shall be considered to be inadequate for all purposes without notification of any specific inadequacy. In any case where a notice of sale does not contain the information required under paragraph (d)(1)(ii) of this section with respect to a Notice of Federal Tax Lien, the IRS may give written notification of such omission without specification of any other inadequacy and such notice of sale shall be considered inadequate for all purposes. In the event the IRS gives notification that the notice of sale is inadequate, a notice complying with the provisions of this section (including the requirement that the notice be given not less than 25 days prior to the sale in the case of a notice described in paragraph (a) of this section) must be given. However, in accordance with the provisions of paragraph (b)(1) of this section, in such a case the IRS may, in its discretion, consent to the

sale of the property free of the lien or title of the United States even though notice of the sale is given less than 25 days prior to the sale. In any case where the person who submitted a timely notice which indicates his name and address does not receive, more than 5 days prior to the date of sale, written notification from the IRS that the notice is inadequate, the notice shall be considered adequate for purposes of this section.

(3) *Acknowledgment of notice*. If a notice of sale described in paragraph (a) or (c) of this section is submitted in duplicate to the IRS with a written request that receipt of the notice be acknowledged and returned to the person giving the notice, this request will be honored by the IRS. The acknowledgment by the IRS will indicate the date and time of the receipt of the notice.

(4) *Disclosure of adequacy of notice*. The IRS is authorized to disclose, to any person who has a proper interest, whether an adequate notice of sale was given under paragraph (d)(1) of this section. Any person desiring this information should submit to the IRS a written request which clearly describes the property sold or to be sold, identifies the applicable notice of lien, gives the reasons for requesting the information, and states the name and address of the person making the request. The request should be submitted to the IRS official, office and address specified in IRS Publication 4235, "*Technical Services (Advisory) Group Addresses*," or its successor publication. The relevant IRS publications may be downloaded from the IRS internet site at *www.irs.gov*.

(e) *Effective/applicability date*. This section applies to any notice of sale that is filed after **August 20, 2007**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 11, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39737)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2007. See Rev. Rul. 2007-57, page 531.

Section 7874.—Rules Relating to Expatriated Entities and Their Foreign Parents

Final regulations under section 1502 of the Code allow the Internal Revenue Service to appoint a domestic substitute agent for a consolidated group when the group's parent is a foreign corporation that is treated as a domestic corporation under section 7874 of the Code. See T.D. 9343, page 533.

Part II. Treaties and Tax Legislation
Subpart A.—Tax Conventions and Other Related Items

U.S.-Netherlands: Qualification of Certain Pension and Other Employee Benefit Arrangements

Announcement 2007–75

The following is a copy of the Competent Authority Agreement ("CAA") entered into by the Competent Authorities of the United States and the Netherlands with respect to the qualification of certain tax-exempt trusts, companies, or other organizations for benefits under Article 35 of the U.S.-Netherlands income tax treaty. The CAA also provides guidelines for claiming treaty benefits in each country and the methods each country will use to grant treaty benefits.

The text of the CAA is as follows:

COMPETENT AUTHORITY AGREEMENT

The Competent Authorities of the Netherlands and the United States hereby amend and restate the agreement that they entered into on March 23, 2000[1], with respect to the qualification of certain tax-exempt trusts, companies, or other organizations for benefits under Article 35 of the Convention between the Kingdom of the Netherlands and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on December 18, 1992, and amended by Protocols signed on October 13, 1993 and March 8, 2004 (the "Treaty"). The agreement specifies the procedures for claiming treaty benefits in each country and the methods each country will use to grant treaty benefits.

This agreement constitutes a Mutual Agreement in accordance with Article 29 of the Treaty.

Chapter I

Qualification for treaty benefits under Article 35 of the 1992 Netherlands-US income tax treaty

Paragraph 1 of Article 35 of the Treaty provides that dividends or interest derived by a trust, company, or other organization constituted and operated exclusively to administer or provide benefits under one or more funds or plans established to provide pension, retirement, or other employee benefits shall be exempt from tax in one Contracting State if it is a resident of the other Contracting State according to the laws of that other State and its income is generally exempt from tax in that other State. Paragraph 2 provides that the provisions of paragraph 1 do not apply with respect to the income of a trust, company, or other organization from carrying on a trade or business or from a related person other than a person referred to in paragraph 1.

Questions have been raised regarding the types of trusts, companies, or other organizations that qualify for benefits under Article 35 of the Treaty. In practice, there are many different types of funds or plans established to provide pension, retirement, or other employee benefits and it is not always clear which of these funds or plans fulfill the requirements of Article 35. In view of this uncertainty, the competent authorities of the Netherlands and the United States agree that the types of trusts, companies, or other organizations mentioned in chapters II and IV of this agreement are considered to fall within the scope of Article 35.

It is understood that for the purpose of this agreement the term "Code section" refers to a section of the U.S. Internal Revenue Code of 1986, as amended, and that the term "trust" includes a custodial account treated as a trust for U.S. federal income tax purposes.

Chapter II

U.S. resident tax-exempt trusts, companies, or other organizations

Subject to the conditions of Article 26, paragraph 2 of Article 35, and paragraph 4 of Article 34 of the Treaty, the following types of U.S. resident trusts, companies, or other organizations are treated as the beneficial owners of dividends and interest derived from the Netherlands and are considered to qualify for benefits under Article 35 of the Treaty:

1. a U.S. resident tax-exempt trust providing pension or retirement benefits under a Code section 401(a) qualified pension plan, profit sharing plan or stock bonus plan (including Code section 401(k) arrangements);
2. a U.S. resident tax-exempt trust described in Code section 457(g) providing pension or retirement benefits under a Code section 457(b) plan;
3. a U.S. resident tax-exempt trust providing pension or retirement benefits under a Code section 403(b) plan;
4. a U.S. resident tax-exempt trust that is an individual retirement account (Code section 408), a Roth individual retirement account (Code section 408A), or a simple retirement account, or a U.S. resident tax-exempt trust that is providing pension or retirement benefits under a simplified employee pension plan;
5. a group trust described in IRS Revenue Ruling 81–100 and meeting the conditions of IRS Revenue Ruling 2004–67;
6. a U.S. resident common trust fund (Code section 584) to the extent that the participants are trusts mentioned under points 1) through 5) above;
7. the Thrift Savings Fund (Code section 7701(j)); and
8. a voluntary employees' beneficiary association (Code section 501(c)(9)).

However, a U.S. resident tax-exempt trust mentioned under points 2), 3), or 4) above will not be considered to qualify for treaty benefits under Article 35 of the Treaty in any taxable year if less than 70% of the total amount of the withdrawals

[1] Dutch Form IB 96 USA uses the date March 27, 2000, which was the date the original agreement was published in the Staatscourant, but the competent authorities here refer to the same original mutual agreement as is referred to in Form IB–96–USA.

from such U.S. trust during that year is used to provide pension, retirement or other employee benefits as meant in Article 35 of the Treaty.

Any type of U.S. resident tax-exempt trust, company, or other organization not mentioned above, that considers itself to qualify for benefits under Article 35 of the Treaty, may present its case to the Netherlands tax unit Belastingdienst Limburg / kantoor Buitenland (address: P.O. Box 2865, 6401 DJ HEERLEN, The Netherlands), or to the U.S. competent authority (see Rev. Proc. 2006–54, 2006–49 I.R.B. 1035) requesting competent authority consideration under Article 29 of the Treaty.

Chapter III

Appropriate procedures for filing a request for an application of treaty benefits in the Netherlands

A trust, company, or other organization that qualifies for benefits under Article 35 of the Treaty may claim benefits with respect to income derived from the Netherlands referred to in Article 10 (Dividends). The Netherlands does not apply a withholding tax on outgoing interest payments as meant in Article 12 of the Treaty.

The Netherlands has two methods for granting benefits for Dutch source dividend income: the so-called exemption method (in which case the treaty rate is applied at source) and the so-called refund method.

As a general rule, the Netherlands applies the exemption method when granting treaty benefits in the case of Dutch source dividend income received by a resident of the United States, which means that treaty benefits will be granted by means of an exemption from Netherlands withholding tax at source. In view of the Netherlands competent authority's preference for a closer monitoring of all requests filed for an application of benefits under Article 35 of the Treaty, a U.S. resident tax-exempt trust (including a U.S. common trust fund or group trust) mentioned in point 1) through 8) of chapter II of this agreement shall — as a general rule — be required to use the refund method when filing its request for an application of benefits under Article 35 of the Treaty. Only if the conditions listed below are fulfilled, may such a U.S. resident tax-exempt trust use the exemption method when filing its request for an application of benefits under Article 35 of the Treaty.

The Netherlands 2007 regulations for the implementation of the Treaty give a detailed description of the procedures to be applied in the case of both the exemption method and the refund method.

The exemption method may be used if the U.S. resident tax-exempt trust, company, or other organization requesting benefits under Article 35 of the Treaty:

* provides to the appropriate Dutch withholding agent or payor, Form 6166, a U.S. residency certification letter issued by the U.S. Internal Revenue Service for the applicable taxable year(s) (Form 6166 may be obtained by filing Form 8802 (Application for United States Residency Certification) in accordance with the instructions for Form 8802) stating that the entity in question is a trust forming part of a pension, profit sharing, or stock bonus plan qualified under Code section 401(a) of the Internal Revenue Code (an example of Form 6166 is attached); or

* provides to the appropriate Dutch withholding agent or payor, a so-called "qualification" certification issued by the competent Netherlands tax authorities, stating that the entity in question is a U.S. resident tax-exempt trust, company, or other organization described in paragraph 1 of Article 35 of the Treaty.

Requests for a "qualification" certification may be filed with the tax unit Belastingdienst Limburg / kantoor Buitenland (address: P.O. Box 2865, 6401 DJ HEERLEN, The Netherlands).

A "qualification" certification, issued by the competent Netherlands tax authorities, is in principle valid indefinitely. However, a "qualification" certification will no longer be valid in the event:

*there is a material change in facts or circumstances; or

*It is determined that the "qualification" certification was issued erroneously; or

*the U.S. resident tax-exempt entity in question has not claimed an application of benefits under Article 35 of the Treaty for five consecutive calendar years. Since Form 6166 issued by the U.S. Internal Revenue Service is not valid indefinitely, a U.S. resident tax-exempt entity that has been issued a Form 6166 by the U.S. Internal Revenue Service may also file a request for a "qualification" certification with the competent Netherlands tax authorities.

Irrespective of the above, use of the refund method is mandatory in any taxable year for a U.S. resident tax-exempt entity mentioned under point 2) or 4) of chapter II, if less than 70% of the total amount of the withdrawals from such U.S. trust during that year is used to provide pension or retirement benefits.

Where assets of the pension fund(s) or pension plan(s) are held in custodial accounts, the Dutch Form IB 96 USA requires a certification that the claim for a refund of Dutch dividend tax is filed for the benefit of the custodial accounts in question.

The status of all U.S. resident tax-exempt trusts, companies, or other organizations claiming benefits under Article 35 of the Treaty may at any time be subject to verification by the competent Netherlands tax authority. If considered necessary, use will be made of the exchange of information procedure (Article 30 of the Treaty).

Chapter IV

Netherlands resident tax-exempt trusts, companies, or other organizations

Subject to the conditions of Article 26, paragraph 2 of Article 35, and paragraph 4 of Article 34 of the Treaty, the following types of Netherlands resident trusts, companies, or other organizations are treated as beneficial owners of dividends and interest derived from the United States and are considered to qualify for benefits under Article 35 of the Treaty:

1. a Netherlands resident tax-exempt company constituted and operated exclusively to administer or provide benefits as meant in article 5, paragraph 1, under b), of the Netherlands corporation tax act (including a Netherlands resident tax-exempt company constituted and operated exclusively to administer or provide benefits under a pension plan as meant in article 3.13, paragraph 1, under b), of the Netherlands income tax act);
2. a Netherlands fund that is exempt under the Netherlands corporation tax

act and constituted by a Netherlands labor union and operated exclusively to administer or provide benefits to its members in case they are on strike (stakingskassen) and of which the payments are exempt under article 3.13, paragraph 1, under f), of the Netherlands income tax act; and

3. Netherlands limited fund for mutual account (besloten fondsen voor gemene rekening) in which each participant is a Netherlands resident tax-exempt company mentioned under points 1) or 2) above.

Any type of Netherlands resident tax-exempt trust, company, or other organization not mentioned above, that considers itself to qualify for benefits under Article 35 of the Treaty, may present its case to the U.S. competent authority, or to the Netherlands competent authority requesting competent authority consideration under Article 29 of the Treaty.

Chapter V

Appropriate procedures for filing a request for an application of treaty benefits in the United States

Under U.S. tax law, a Netherlands resident taxpayer (including a Netherlands resident tax-exempt entity referred to in Article 35 of the Treaty) may file for an application of treaty benefits at source, or may claim a refund of U.S. income tax withheld according to regulations set forth under the Internal Revenue Code. The following procedures apply to a Netherlands resident tax-exempt trust, company, or other organization.

A Netherlands resident tax-exempt trust, company, or other organization described in this agreement should claim exemption from U.S. income tax withholding under Article 35 of the Treaty on dividends or interest income referred to in Articles 10 and 12, respectively, of the Treaty by providing a properly completed IRS Form W–8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) to the appropriate withholding agent or payer of such income before the income is paid or credited to the company. An entity filing Form W–8BEN should cite Article 35 of the Treaty on line 10 thereof, and state that it is a Netherlands resident tax-exempt trust, company, or other organization described in chapter IV of this agreement.

Alternatively, the trust, company, or other organization may seek a refund of taxes withheld on such dividend or interest income by timely filing a U.S. income tax return and claiming a refund of such taxes.

The status of all Netherlands resident tax-exempt trusts, companies, or other organizations providing pension, retirement, or other employee benefits and claiming benefits under Article 35 of the Treaty may be subject to verification by the Internal Revenue Service. If considered necessary, use will be made of the exchange of information procedure (Article 30 of the Treaty).

As amended by Article 6 of the Protocol signed on October 13, 1993, paragraph 2 of Article 35 of the Treaty provides that dividends paid by a person resident in the United States that is a Real Estate Investment Trust ("REIT") from gains realized on the disposition of real property situated in the United States are not eligible for benefits under Article 35. Such distributions are subject to U.S. tax under paragraph 1 of Article 14 of the Treaty. In addition, distributions paid by a person resident in the United States that is a Regulated Investment Company ("RIC") from gains realized on the disposition of real property situated in the United States are not eligible for benefits under Article 35 and are subject to U.S. tax under paragraph 1 of Article 14.

Pursuant to section 897(h)(1) of the Internal Revenue Code, as amended, certain amounts distributed by qualified investment entities (REITs and certain RICs) that would have otherwise been treated as distributions from gains realized on the disposition of real property situated in the United States are treated and taxed as dividends. Such amounts will be treated as dividends that are eligible for exclusion under paragraph 1 of Article 35.

Paragraph 2 of Article 35 also provides that income of a trust, company, or other organization is not exempt under Article 35 if it is derived from carrying on a trade or business or from a related person that is not itself eligible for benefits under Article 35. Paragraph XXXVII of the Understanding accompanying the Protocol signed on March 8, 2004 provides that for purposes of paragraph 2 of Article 35, a person will be considered to be a "related person" if more than 80 percent of the vote or value of any class of shares is owned by the person deriving the income.

Agreed to by the undersigned competent authorities:

Frank Y. Ng
U.S. Competent Authority

Maarten Brabers
Netherlands Competent Authority

CERTIFICATION
PROGRAM

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
PHILADELPHIA, PA 19255

Date: 7/12/2007

Taxpayer: ABC PENSION PLAN
TIN: XX-XXXXXXX
Tax Year: 2007

I certify that, to the best of our knowledge, the above-named entity is a trust forming part of a pension, profit sharing, or stock bonus plan qualified under section 401(a) of the U.S. Internal Revenue Code, which is exempt from U.S. taxation under section 501(a), and is a resident of the United States of America for purposes of U.S. taxation.

Andrew E. Zuckerman
Field Director, Philadelphia Accounts Management Center

Form 6166 (Rev. 3-2006) Catalog Number 43134V Department of the Treasury-Internal Revenue Service

Part III. Administrative, Procedural, and Miscellaneous

Transaction of Interest — Contribution of Successor Member Interest

Notice 2007–72

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which a taxpayer directly or indirectly acquires certain rights in real property or in an entity that directly or indirectly holds real property, transfers the rights more than one year after the acquisition to an organization described in § 170(c) of the Internal Revenue Code, and claims a charitable contribution deduction under § 170 that is significantly higher than the amount that the taxpayer paid to acquire the rights. The IRS and the Treasury Department believe this transaction has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction. This notice identifies this transaction, and substantially similar transactions, as transactions of interest for purposes of § 1.6011–4(b)(6) of the Income Tax Regulations and §§ 6111 and 6112. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

In a typical transaction, Advisor owns all of the membership interests in a limited liability company (LLC) that directly or indirectly owns real property (other than a personal residence as defined in § 1.170A–7(b)(3)) that may be subject to a long-term lease. Advisor and Taxpayer enter into an agreement under the terms of which Advisor continues to own the membership interests in LLC for a term of years (the Initial Member Interest), and Taxpayer purchases the successor member interest in LLC (the Successor Member Interest), which entitles Taxpayer to own all of the membership interests in LLC upon the expiration of the term of years. In some variations of this transaction, Taxpayer may hold the Successor Member Interest through another entity, such as a single member limited liability company. Further, the agreement may refer to the Successor Member Interest as a remainder interest.

After holding the Successor Member Interest for more than one year (in order to treat the interest as long-term capital gain property), Taxpayer transfers the Successor Member Interest to an organization described in § 170(c) (Charity).

Taxpayer claims the value of the Successor Member Interest to be an amount that is significantly higher than Taxpayer's purchase price (for example, an amount that is a multiple of Taxpayer's purchase price and exceeds normal appreciation). Taxpayer claims a charitable contribution deduction under § 170 based on this higher amount. Taxpayer reaches this value by taking into account an appraisal obtained by or on behalf of Advisor or Taxpayer of the fee interest in the underlying real property and the § 7520 valuation tables.

The Internal Revenue Service and the Treasury Department are concerned about apparent irregularities in this transaction. Specifically, the IRS and the Treasury Department are concerned with the large discrepancy between (1) the amount Taxpayer paid for the Successor Member Interest, and (2) the amount claimed by Taxpayer as a charitable contribution. The IRS and the Treasury Department also have the following additional concerns, which may be present in some variations of this transaction: (1) any mischaracterization of the ownership interests in LLC; (2) a Charity's agreement not to transfer the Successor Member Interest for a period of time (which may coincide with the expiration of the applicable period in § 6050L(a)(1)); and (3) any sale by Charity of the Successor Member Interest to a party selected by or related to Advisor or Taxpayer.

TRANSACTION OF INTEREST

Effective Date

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as transactions of interest for purposes of § 1.6011–4(b)(6) and §§ 6111 and 6112 effective August 14, 2007, the date this notice was released to the public. Persons entering into these transactions on or after November 2, 2006, must disclose the transaction as described in § 1.6011–4. Material advisors who make a tax statement on or after November 2, 2006, with respect to transactions entered into on or after November 2, 2006, have disclosure and list maintenance obligations under §§ 6111 and 6112. See § 1.6011–4(h) and §§ 301.6111–3(i) and 301.6112–1(g) of the Procedure and Administration Regulations.

Independent of their classification as transactions of interest, transactions that are the same as, or substantially similar to, the transaction described in this notice already may be subject to the requirements of § 6011, 6111, or 6112, or the regulations thereunder. When the IRS and the Treasury Department have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the IRS and the Treasury Department may take one or more actions, including removing the transaction from the transactions of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction.

Participation

Under § 1.6011–4(c)(3)(i)(E), Advisor, LLC or any entity used in place of LLC, Taxpayer, and any members of Taxpayer if Taxpayer is a flow-through entity, are participants in this transaction for each year in which their respective tax returns reflect tax consequences or the tax strategy described in this notice.

Charity is not a participant if it received the Successor Member Interest described in this notice on or prior to August 14, 2007. For Successor Member Interests received after August 14, 2007, under § 1.6011–4(c)(3)(i)(E) Charity is a participant in this transaction for the first year for which Charity's tax return reflects the Successor Member Interest described in this notice. In general, Charity is required to report the receipt of the Successor Member Interest described in this notice on its return for the year in which it is received. See § 6033. Therefore, in general, Charity will be a participant

for the year in which Charity received the Successor Member Interest.

Time for Disclosure

See § 1.6011–4(e) and § 301.6111–3(e).

Material Advisor Threshold Amount

The threshold amounts are the same as those for listed transactions. See § 301.6111–3(b)(3)(i)(B).

Penalties

Persons required to disclose these transactions under § 1.6011–4 who fail to do so may be subject to the penalty under § 6707A. Persons required to disclose these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of advisees under § 6112 who fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose other penalties on persons involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or 6662A.

DRAFTING INFORMATION

The principal authors of this notice are Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax and Accounting) and Leslie H. Finlow of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information concerning this notice generally, contact Ms. Zweibel at (202) 622–7900 (not a toll-free call). For further information concerning the sections of this notice under the heading TRANSACTIONS OF INTEREST, contact Ms. Finlow at (202) 622–3070 (not a toll-free call).

Transaction of Interest — Toggling Grantor Trust

Notice 2007–73

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, that uses a grantor trust, and the purported termination and subsequent re-creation of the trust's grantor trust status, for the purpose of allowing the grantor to claim a tax loss greater than any actual economic loss sustained by the taxpayer or to avoid inappropriately the recognition of gain. The IRS and Treasury Department believe this transaction has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction. This notice identifies this transaction, and substantially similar transactions, as transactions of interest for purposes of § 1.6011–4(b)(6) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts persons involved with these transactions to certain responsibilities that may arise from their involvement with these transactions.

FACTS

In one variation of the transaction, Grantor purchases four options. The value of each one of the options is expected to move inversely in relation to at least one of the other options over a relevant range of values so that, before expiration of any one of the options, there will be a gain in two options (gain options) and a substantially offsetting loss in the other two options (loss options). Grantor creates Trust and funds Trust with the options and a small amount of cash. Grantor gives a short-term unitrust interest in Trust to Beneficiary and retains a noncontingent remainder interest in Trust. The remainder interest is structured to have a value as determined under § 7520 that equals the fair market value of the options. Grantor takes the position that Grantor's remainder interest is a qualified interest under § 2702. Because of the retained remainder interest, Grantor treats Trust as a trust owned by Grantor under subpart E (§ 671 and following), part I, subchapter J, chapter 1 of the Code (a grantor trust). The trust agreement also provides that Grantor will have the power, exercisable in a nonfiduciary capacity, to reacquire Trust corpus by substituting other property of an equivalent value (the substitution power) and that this substitution power will become effective on a specified date in the future. See § 675(4).

After establishing and funding Trust, Grantor sells the remainder interest in Trust to an unrelated person (Buyer) for an amount equal to the fair market value of the remainder interest (which is equal to the fair market value of the options). Grantor claims that the basis in the remainder interest is determined by allocating to the remainder interest a portion of the basis in all of the Trust assets (based on the respective fair market values of the remainder and unitrust interests at the time of the sale). Therefore, Grantor claims there is no gain recognized on the sale of the remainder interest because Grantor's basis in the remainder interest is the same as the amount realized (prearranged to be equivalent to the fair market value of the options). Buyer gives Grantor an installment obligation (Note), cash, or other consideration for the remainder interest. Grantor claims that the sale of the remainder interest has terminated (toggled off) the grantor trust status of Trust so that, during the period after the sale and before the effective date of the substitution power, Trust is no longer a grantor trust under § 671.

Grantor claims that, once the substitution power becomes effective, Trust's grantor trust status is restarted (toggled on). The loss options are then closed out. The amount Grantor paid for those options (the original basis of those options) is greater than the amount Trust receives when the loss options are closed out. Grantor claims that Trust's status as a grantor trust causes Grantor to recognize the loss on the two loss options. Grantor calculates the loss based on the difference between the amount realized and the original basis in the loss options, even though Grantor previously used a portion of the basis in the Trust assets (equivalent to the basis in all of the options) to eliminate Grantor's gain on the sale of the remainder interest. Trust's remaining assets then consist of the two gain options, the contributed cash, and amounts received, if any, upon the termination of the loss options.

Buyer then purchases the unitrust interest in Trust from Beneficiary for an amount equal to the actuarial value of that interest (which equals or approximates the amount of cash Grantor contributed to

Trust), making Buyer the owner of both the remainder interest and the unitrust interest. Trust then terminates (by operation of law or Buyer's action), and Trust's assets are distributed to Buyer. Buyer claims a basis in the assets (the gain options and the cash) from Trust equal to the amount paid by Buyer for the two separate interests in Trust. Grantor does not treat the termination of Trust as a taxable disposition by Grantor of the assets of Trust.

The gain options are exercised or sold, or otherwise terminate, and Buyer claims to recognize gain on the gain options only to the extent that the amount realized exceeds the basis Buyer allocates to the gain options. The transaction has been structured so that any gain recognized would be minimal. If Buyer purchased the remainder interest from Grantor with a Note, Buyer uses the proceeds from the options to pay the Note. If Grantor borrowed to purchase the options, Grantor repays the loan from the Note proceeds.

In another variation of the transaction, the facts are the same as described above except for the following. Grantor contributes to Trust liquid assets such as cash or marketable securities, rather than options. Grantor's basis in the contributed assets equals or is approximately equal to the fair market value of the assets at the time of contribution. Before the specified date on which Grantor's substitution power becomes effective, Grantor sells the remainder interest in Trust to Buyer for an amount equal to the fair market value of the remainder interest and claims to recognize no gain or a minimal gain or loss for the same reason as described above. As in the prior variation, Grantor claims that the sale terminates (toggles off) Trust's grantor trust status. After the substitution power becomes effective, Grantor substitutes appreciated property for Trust's liquid assets. The fair market value of the substituted property is equivalent to the fair market value of the liquid assets. Grantor claims that, once the substitution power becomes effective (prior to the exchange), Trust's grantor trust status is restarted (toggled on), and, therefore, the substitution will not cause Grantor to recognize gain.

As described above, Buyer purchases the unitrust interest in Trust from Beneficiary, terminates Trust, and receives Trust's assets on distribution. For tax purposes, Grantor does not treat the termination of Trust as a disposition by Grantor of the appreciated assets in Trust. Buyer claims a basis in the assets of Trust (the appreciated property and cash) equal to the amount paid by Buyer for the interests in Trust.

One of the purported tax consequences of the first variation of the transaction is that Grantor sells the remainder interest and receives an amount substantially equal to the fair market value of the (non-cash) assets contributed to Trust but nevertheless claims a tax loss attributable to those assets even though Grantor has not suffered an equivalent economic loss. One of the purported tax consequences of the second variation of the transaction is that Grantor avoids the recognition of gain on the disposition of the appreciated assets substituted for the original assets contributed to Trust.

These transactions usually occur within a short period of time during the taxable year (typically within 30 days), and, in each case, Grantor claims that the termination and subsequent reestablishment of grantor trust status, combined with the series of events regarding Trust's assets, result in tax consequences that could not be achieved without both the toggling off and on of grantor trust status. The transactions in this notice, as described above, do not include the situation where a trust's grantor trust status is terminated, unless there is also a subsequent toggling back to the trust's original status for income tax purposes.

TRANSACTION OF INTEREST

Effective Date

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as transactions of interest for purposes of § 1.6011–4(b)(6) and §§ 6111 and 6112 effective August 14, 2007, the date this notice was released to the public. Persons entering into these transactions on or after November 2, 2006, must disclose the transaction as described in § 1.6011–4. Material advisors who make a tax statement on or after November 2, 2006, with respect to transactions entered into on or after November 2, 2006, have disclosure and list maintenance obligations under §§ 6111 and 6112. See § 1.6011–4(h) and §§ 301.6111–3(i) and 301.6112–1(g) of the Procedure and Administration Regulations.

Independent of their classification as transactions of interest, transactions that are the same as, or substantially similar to, the transaction described in this notice may already be subject to the requirements of §§ 6011, 6111, or 6112, or the regulations thereunder. When the IRS and Treasury Department have gathered enough information to make an informed decision as to whether this transaction is a tax avoidance type of transaction, the IRS and Treasury Department may take one or more actions, including removing the transaction from the transactions of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction.

Participation

Under § 1.6011–4(c)(3)(i)(E), Grantor, Buyer, and Beneficiary are participants in this transaction for each year in which their respective tax returns reflect tax consequences or a tax strategy described in this notice.

Time for Disclosure

See § 1.6011–4(e) and § 301.6111–3(e).

Material Advisor Threshold Amount

The threshold amounts are the same as those for listed transactions. See § 301.6111–3(b)(3)(i)(B).

Penalties

Persons required to disclose these transactions under § 1.6011–4 who fail to do so may be subject to the penalty under § 6707A. Persons required to disclose these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of advisees under § 6112 who fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose other penalties on parties involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or § 6662A.

DRAFTING INFORMATION

The principal author of this notice is Tolsun N. Waddle of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Waddle at (202) 622–3070 (not a toll-free call).

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26 CFR 31.3402(q): Return of information on proceeds from poker tournaments.
(Also: § 3406.)

Rev. Proc. 2007–57

SECTION 1. PURPOSE

This revenue procedure informs taxpayers of their obligations under section 3402(q) pertaining to withholding and information reporting applicable to certain amounts paid to winners of poker tournaments. It further sets forth procedures to be used to comply with the relevant requirements of the Internal Revenue Code and Treasury Regulations thereunder.

SECTION 2. FACTUAL BACKGROUND

A business taxpayer ("poker tournament sponsor") may sponsor a poker tournament, charging an entry fee and a "buy-in" fee for each participant. In exchange for the fees, each participant receives a set of poker chips with a nominal face value for use in the specific poker tournament. The poker tournament sponsor pays amounts, which exceed a participant's fees by $5,000, to a certain number of tournament winner(s), out of a pool comprised of all the participants' fees.

SECTION 3. LEGAL BACKGROUND

.01. *Withholding under section 3402.* Section 3402(q)(1) provides that every person who makes any payment of winnings which are subject to withholding shall deduct and withhold from the payment an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment. Section 3402(q)(3) provides that the term "winnings which are subject to withholding" means, in part, proceeds from a wagering transaction, if the proceeds are more than $5,000 from a wager placed in any sweepstakes, wagering pool, or lottery. The term "wagering pool" includes "all pari-mutuel betting pools, including on- and off-track racing pools, and similar types of betting pools." H.R. Conf. Rep. No. 94–1515, at 488 (1976) (relating to the enactment of § 3402(q)). "In common usage the term 'pool' connotes a particular gambling practice, an arrangement whereby all bets constitute a common fund to be taken by the winner or winners." *United States v. Berent*, 523 F.2d 1360, 1361 (9th Cir. 1975). Section 3402(q)(4)(A) provides that proceeds from a wager shall be determined by reducing the amount received by the amount of the wager.

.02. *Information reporting under section 31.3402(q)–1(e).* Section 31.3402(q)–1(e) of the Employment Tax Regulations provides that each person who is to receive a payment of winnings subject to withholding shall furnish to the payer a statement on Form W–2G or Form 5754 (whichever is applicable) made under the penalties of perjury containing certain required information, including the name, address, and Taxpayer Identification Number of the winning payee. Section 31.3402(q)–1(f)(1) provides that every person making a payment of winnings for which withholding is required shall file a Form W–2G with the IRS on or before February 28 (March 31 if filed electronically) of the calendar year following the calendar year in which the payment of winnings is made and shall furnish a copy of the Form to the payee.

SECTION 4. APPLICATION

A poker tournament sponsor is required to withhold and report on payments of more than $5,000 made to a winning payee in a taxable year by filing an information return with the IRS as prescribed by section 3402(q). The poker tournament sponsor must furnish a copy of the information return to the IRS on or before February 28 (March 31 if filed electronically) of the calendar year following the calendar year in which the payment is made, as prescribed by section 31.3402(q) of the regulations.

SECTION 5. SCOPE

This revenue procedure applies to poker tournament sponsors, including casinos, which pay amounts to winners in a manner substantially similar to that described in section 2 of this revenue procedure.

SECTION 6. WAIVER OF LIABILITY UNDER SECTION 3402 AND WAIVER OF OTHER PENALTIES OR ADDITIONS TO TAX

The IRS will not assert any liability for additional tax or additions to tax for violations of any withholding obligation with respect to amounts paid to winners of poker tournaments under section 3402, provided that the poker tournament sponsor meets all of the requirements for information reporting under section 3402(q) and the regulations thereunder.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for payments made on or after March 4, 2008.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Blaise G. Dusenberry of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue procedure, contact Cynthia McGreevy at (202) 622–4910 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Abandonment of Stock and Other Securities

REG–101001–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance concerning the availability and character of a loss deduction under section 165 of the Internal Revenue Code for losses sustained from abandoned securities. These proposed regulations are necessary to clarify the tax treatment of losses from abandoned securities, and will affect any taxpayer claiming a deduction for a loss from abandoned securities after the date these regulations are published as final regulations in the **Federal Register**.

DATES: Written or electronic comments and requests for a public hearing must be received by October 29, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–101001–05), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–101001–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the IRS internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS REG–101001–05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Lisa S. Dobson at (202) 622–7790, or Sean M. Dwyer at (202) 622–5020; concerning submissions of comments and requests for a hearing, Kelly Banks at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document proposes to amend §1.165–5 of the Income Tax Regulations (26 CFR part 1) to provide guidance concerning the Federal income tax treatment of abandoned securities.

Abandonment of Securities

Section 165(a) of the Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 1.165–1(d)(1) of the Income Tax Regulations provides that a loss is treated as sustained during the taxable year in which the loss occurs, as evidenced by a closed and completed transaction, and as fixed by an identifiable event occurring in such taxable year.

Section 165(g)(1) provides that if any security that is a capital asset becomes worthless during the taxable year, the resulting loss is treated as a loss from the sale or exchange of a capital asset (that is, as a capital loss) on the last day of the taxable year. Section 165(g)(2) defines *security* as a share of stock in a corporation; a right to subscribe for or to receive a share of stock in a corporation; or a bond, debenture, note or certificate or other evidence of indebtedness issued by a corporation or government with interest coupons or in registered form. Section 165(g)(3) provides an exception from capital loss treatment for certain worthless securities in a domestic corporation affiliated with the taxpayer.

The legislative history of the predecessor of section 165(g) indicates that the provision was enacted to remove the "peculiar and anomalous results" that followed from treating losses from the worthlessness of securities as ordinary losses or deductions, and losses from the sale or exchange of securities as capital losses, because both losses represent a loss of capital in a transaction entered into for profit. See H. Rep. No. 1860, 75th Cong., 3d Sess., at 18–19 (1938).

The Treasury Department and the IRS understand that some taxpayers have taken the position that a loss under section 165(a) resulting from the abandonment of a security is not subject to the loss characterization rules provided in section 165(g).

Property that has become worthless to the taxpayer may give rise to a loss deduction under section 165(a). In general, worthlessness is determined by a combination of subjective and objective *indicia* including a subjective determination of worthlessness to the taxpayer and objective evidence of a closed and completed transaction. See *Echols v. Commissioner*, 950 F.2d 209 (5th Cir. 1991); *Boehm v. Commissioner*, 326 U.S. 287 (1945). For purposes of section 165(a), the act of abandonment is an event that establishes both of these elements. Rev. Rul. 2004–58, 2004–1 C.B. 1043, see §601.601(d)(2)(ii)(*b*). Although an act of abandonment may be "one of several factors in the analysis of whether the taxpayer's subjective determination of an asset's worthlessness is sustainable, abandonment is not an indispensable requirement for a worthlessness deduction under Code section 165." *Echols*, 950 F.2d at 212. Identifiable events may include "other acts or events which reflect the fact that the property is worthless." *Proesel v. Commissioner*, 77 T.C. 992, 1005 (1981).

The proposed regulations provide that, for purposes of applying the loss characterization rules of section 165(g), the abandonment of a security establishes the worthlessness of the security to the taxpayer. Under the proposed regulations a loss established by the abandonment of a security that is a capital asset is treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset, unless the exception in section 165(g)(3) applies. In characterizing losses established by the abandonment of a security in a manner consistent with other worthless security losses, the proposed regulations further the legislative intent to eliminate "peculiar and anomalous results." See H. Rep. No. 1860, 75th Cong., 3d Sess., at 18–19 (1938). See also §1.332–2(b) and Rev. Rul. 2003–125, 2003–2 C.B. 1243, see §601.601(d)(2)(ii)(*b*), (wherein the character of a loss established in a transaction in which a shareholder disposes

of stock and receives no consideration (specifically, a liquidation that fails to qualify under section 332) is prescribed by section 165(g)).

Although a taxpayer need not relinquish legal title to property in all cases to establish abandonment, in view of the nature of a taxpayer's rights in stock and other securities these proposed regulations require that to abandon a security, a taxpayer must permanently surrender and relinquish all rights in the security and receive no consideration in exchange for the security.

Abandonment or Cancellation of Other Debt Instruments

Section 166(a)(1) allows as a deduction any debt which becomes worthless within the taxable year. Under section 166(b), the basis for determining the amount of the deduction is the adjusted basis of the debt. Section 166(a)(2) permits a deduction for partially worthless debts. It provides that the Secretary, when satisfied that a debt is recoverable only in part, may allow a deduction for the debt in an amount not in excess of the part charged off within the taxable year. The courts have noted that the tests for worthlessness under section 165 and under section 166 are fundamentally the same. See *United States v. S.S. White Dental Mfg. Co.*, 274 U.S. 398, 401 (1927).

A creditor may not voluntarily cancel a debt that has value and claim a deduction under section 166 because the debt is now valueless. See *Jostens, Inc. v. Commissioner*, 956 F.2d 175, 176–77 (8th Cir. 1992).

Two categories of worthless debts are excepted from section 166: nonbusiness debts under section 166(d) and debt securities under section 166(e). Under section 166(e), section 166 does not apply to a debt that is evidenced by a security as defined in section 165(g)(2)(C). Accordingly, the tax treatment of debt securities is discussed in the *Abandonment of Securities* section of this preamble.

Section 166(d)(1)(A) provides that in the case of a taxpayer other than a corporation, section 166(a) does not apply to a nonbusiness debt. Instead, under section 166(d)(1)(B), a nonbusiness debt that becomes worthless is considered a loss from the sale or exchange of a capital asset held for not more than one year. A *nonbusiness debt* is defined in section 166(d)(2) as a debt that is not created or acquired in connection with, or the worthlessness of which is not incurred in, the taxpayer's trade or business. The legislative intent behind section 166(d) is in part to provide for parity of tax treatment with worthless securities under section 165(g) and other investments. See *Putnam v. Commissioner*, 352 U.S. 82, 91–92 (1956).

The Treasury Department and the IRS request comments concerning the Federal tax treatment of "abandoned debt" other than debt securities, including nonbusiness debts which, under section 166(d), are deductible when worthless as short-term capital losses, and other debt instruments, the worthlessness of which gives rise to a bad debt deduction under section 166(a).

Proposed Effective Date

These proposed regulations are proposed to apply to an abandonment of securities occurring after the date these regulations are published as final regulations in the **Federal Register**. No inference is intended regarding the treatment for Federal income tax purposes of an abandonment of securities occurring before these regulations are effective.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed rule and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Although the proposed regulations provide that for purposes of section 165(g) the term *worthless* includes abandoned securities for which no consideration is received, there may be other contexts under the Code or regulations in which the tax treatment of abandoned securities is unclear or in which abandonment and worthlessness should be treated differently. In addition to comments concerning the tax treatment of nonsecurity debt instruments, comments are requested concerning the existence and appropriate tax treatment of abandoned securities in other contexts.

Drafting Information

The principal authors of these regulations are Lisa S. Dobson of the Office of Associate Chief Counsel (Corporate) and Sean M. Dwyer of the Office of Associate Chief Counsel (Income Tax and Accounting). Other personnel from Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.165–5 is amended as follows:

1. Paragraph (i) is redesignated as paragraph (j).

2. A new paragraph (i) is added.

The addition reads as follows:

§1.165–5 Worthless securities.

* * * * *

(i) *Abandonment of securities.* For purposes of section 165 and this section, a security that becomes wholly worthless includes a security described in paragraph (a) of this section that is abandoned and otherwise satisfies the requirements for a deductible loss under section 165. If the abandoned security is a capital asset and is not described in section 165(g)(3) and paragraph (d) of this section (concerning worthless securities of certain affiliated corporations), the resulting loss is treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset. See section 165(g)(1) and paragraph (c) of this section. To abandon a security, a taxpayer must permanently surrender and relinquish all rights in the security and receive no consideration in exchange for the security. For purposes of this section, all the facts and circumstances determine whether the transaction is properly characterized as an abandonment or other type of transaction, such as an actual sale or exchange, contribution to capital, dividend, or gift.

* * * * *

Linda E. Stiff,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 27, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 30, 2007, 72 F.R. 41468)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Change to Office to Which Notices of Nonjudicial Sale and Requests for Return of Wrongfully Levied Property Must Be Sent

REG–148951–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9344) relating to the discharge of liens under section 7425 and return of wrongfully levied upon property under section 6343 of the Internal Revenue Code (Code) of 1986. Those regulations clarify that such notices and claims should be sent to the IRS official and office specified in the relevant IRS publications. The regulations will affect parties seeking to provide the IRS with notice of a nonjudicial foreclosure sale and parties making administrative requests for return of wrongfully levied property. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by **October 18, 2007**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–148951–05), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered to CC:PA:LPD:PR (REG–148951–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to the IRS Internet site via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–148951–05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robin M. Ferguson, (202) 622–3630; concerning submissions of comments, the hearing, call Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in this issue of the Bulletin contain amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to the giving of notice of nonjudicial sales under section 7425(b) of the Code and requests for return of wrongfully levied property under section 6343(b) of the Code. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Proposed Effective Date

These regulations are proposed to apply to any notice of sale filed or request for return of property made after the date that these regulations are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Robin M. Ferguson, Office of Associate Chief Counsel, Procedure and Administration Division.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6343–2 is amended by revising paragraphs (a)(1) introductory text, (b) introductory text, and (e) to read as follows:

§301.6343–2 Return of wrongfully levied upon property.

(a)(1) [The text of the proposed amendment for §301.6343–2(a)(1) introductory text is the same as the text of §301.6343–2T(a)(1) introductory text published elsewhere in this issue of the Bulletin].

* * * * *

(b) [The text of the proposed amendment for §301.6343–2(b) introductory text is the same as the text of §301.6343–2T(b) introductory text published elsewhere in this issue of the Bulletin].

* * * * *

(e) [The text of the proposed amendment for §301.6343–2(e) is the same as the text of §301.6343–2T(e) published elsewhere in this issue of the Bulletin].

Par. 3. Section 301.7425–3 is amended by revising paragraphs (a)(1), (b)(1), (b)(2), (c)(1), (d)(2), (d)(3), and (d)(4), and adding paragraph (e) to read as follows:

§301.7425–3 Discharge of Liens; special rules.

(a) * * * (1) [The text of the proposed amendment for §301.7425–3(a)(1) is the same as the text of §301.7425–3T(a)(1) published elsewhere in this issue of the Bulletin].

* * * * *

(b) * * * (1) [The text of the proposed amendment for §301.7425–3(b)(1) is the same as the text of §301.7425–3T(b)(1) published elsewhere in this issue of the Bulletin].

(2) [The text of the proposed amendment for §301.7425–3(b)(2) is the same as the text of §301.7425–3T(b)(2) published elsewhere in this issue of the Bulletin].

* * * * *

(c) * * * (1) [The text of the proposed amendment for §301.7425–3(c)(1) is the same as the text of §301.7425–3T(c)(1) published elsewhere in this issue of the Bulletin].

* * * * *

(d) * * *

(2) [The text of the proposed amendment for §301.7425–3(d)(2) is the same as the text of §301.7425–3T(d)(2) published elsewhere in this issue of the Bulletin].

(3) [The text of the proposed amendment for §301.7425–3(d)(3) is the same as the text of §301.7425–3T(d)(3) published elsewhere in this issue of the Bulletin].

(4) [The text of the proposed amendment for §301.7425–3(d)(4) is the same as the text of §301.7425–3T(d)(4) published elsewhere in this issue of the Bulletin].

(e) [The text of the proposed amendment for §301.7425–3(e) is the same as the text of §301.7425–3T(e) published elsewhere in this issue of the Bulletin].

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39771)

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 67 Limitations on Estates or Trusts

REG–128224–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance on which costs incurred by estates or non-grantor trusts are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a). The regulations will affect estates and non-grantor trusts. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by October 25, 2007. Outlines of topics to be discussed at the public hearing scheduled for November 14, 2007 must be received by October 24, 2007.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–128224–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–128224–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (indicate IRS and REG–128224–06). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jennifer N. Keeney, (202) 622–3060; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Richard A. Hurst, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1. Section 67(a) of the Internal Revenue Code (Code) provides that, for an individual taxpayer, miscellaneous itemized deductions are allowed only to the extent that the aggregate of those deductions exceeds 2 percent of

adjusted gross income. Section 67(b) excludes certain itemized deductions from the definition of "miscellaneous itemized deductions". Section 67(e) provides that, for purposes of section 67, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual. However, section 67(e)(1) provides that the deductions for costs paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such estate or trust shall be treated as allowable in arriving at adjusted gross income. Therefore, deductions described in section 67(e)(1) are not subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

United States courts of appeals have interpreted the language of section 67(e)(1) differently in determining whether costs incurred by trustees are subject to the 2-percent floor. The issue in each case has been whether the trust's costs (specifically, investment advisory fees) "would not have been incurred if the property were not held in such trust or estate." In *O'Neill v. Commissioner*, 994 F.2d 302 (6th Cir. 1993), the Court of Appeals for the Sixth Circuit held that investment advisory fees paid for professional investment services were fully deductible under section 67(e)(1) where the trustees lacked experience in managing large sums of money. The court found that, under state law, the trustee was required to engage an investment advisor to meet its fiduciary obligations and to incur fees that the trust would not have incurred if the property were not held in trust. The court held that estate or trust expenditures that are necessary to meet specific fiduciary obligations under state law are not subject to the 2-percent floor. In contrast, in *Mellon Bank, N.A. v. United States*, 265 F.3d 1275 (Fed. Cir. 2001), *Scott v. United States*, 328 F.3d 132 (4th Cir. 2003), and *Rudkin v. Commissioner*, 467 F.3d 149 (2d Cir. 2006), the courts held that investment advisory fees are subject to the 2-percent floor. These courts read the language of section 67(e)(1) differently than the Sixth Circuit. Specifically, the courts in *Scott* and *Mellon Bank* concluded that a trust expense is subject to the 2-percent floor if it is an expense "commonly" or "customarily" incurred by individuals; and the court in *Rudkin* looked to whether such an expense was "peculiar to trusts" and "could not" be incurred by an individual.

The result of this lack of consistency in the case law is that the deductions of similarly situated taxpayers may or may not be subject to the 2-percent floor, depending upon the jurisdiction in which the executor or the trustee is located. The IRS and the Treasury Department believe that similarly situated taxpayers should be treated consistently by having section 67(e)(1) construed and applied in the same way in all jurisdictions. The proposed regulations are intended to provide a uniform standard for identifying the types of costs that are not subject to the 2-percent floor under section 67(e)(1).

Explanation of Provisions

These proposed regulations provide that costs incurred by estates or non-grantor trusts that are unique to an estate or trust are not subject to the 2-percent floor. For this purpose, a cost is unique to an estate or trust if an individual could not have incurred that cost in connection with property not held in an estate or trust. To the extent that expenses paid or incurred by an estate or non-grantor trust do not meet this standard, they are subject to the 2-percent floor of section 67(a). (Neither section 67 nor this rule applies to expenses that are excluded under section 67(b) from the definition of miscellaneous itemized deductions, or to expenses related to a trade or business.)

Under the proposed regulations, whether costs are subject to the 2-percent floor on miscellaneous itemized deductions depends on the type of services provided, rather than on taxpayer characterizations or labels for such services. Thus, taxpayers may not circumvent the 2-percent floor by "bundling" investment advisory fees and trustees' fees into a single fee. The regulations provide that, if an estate or non-grantor trust pays a single fee that includes both costs that are unique to estates and trusts and costs that are not, then the estate or non-grantor trust must use a reasonable method to allocate the single fee between the two types of costs. The regulations also provide a non-exclusive list of services for which the cost is either exempt from or subject to the 2-percent floor. The IRS and the Treasury Department invite comments on whether any safe harbors or other guidance, concerning allocation methods or otherwise, would be helpful.

Proposed Effective Date

The regulations, as proposed, apply to payments made after the date final regulations are published in **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the proposed rules, as well as their clarity and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 14, 2007, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before

the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 24, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Jennifer N. Keeney, Office of the Office of Associate Chief Counsel (Passthroughs and Special Industries).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.67–4 is added to read as follows:

§1.67–4 Costs paid or incurred by estates or non-grantor trusts.

(a) *In general.* Section 67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a trust not described in §1.67–2T(g)(1)(i) (a non-grantor trust) and which would not have been incurred if the property were not held in such estate or trust. To the extent that a cost incurred by an estate or non-grantor trust is unique to such an entity, that cost is not subject to the 2-percent floor on miscellaneous itemized deductions. To the extent that a cost included in the definition of miscellaneous itemized deductions and incurred by an estate or non-grantor trust is not unique to such an entity, that cost is subject to the 2-percent floor.

(b) *Unique.* For purposes of this section, a cost is unique to an estate or a non-grantor trust if an individual could not have incurred that cost in connection with property not held in an estate or trust. In making this determination, it is the type of product or service rendered to the estate or trust, rather than the characterization of the cost of that product or service, that is relevant. A non-exclusive list of products or services that are unique to an estate or trust includes those rendered in connection with: fiduciary accountings; judicial or quasi-judicial filings required as part of the administration of the estate or trust; fiduciary income tax and estate tax returns; the division or distribution of income or corpus to or among beneficiaries; trust or will contest or construction; fiduciary bond premiums; and communications with beneficiaries regarding estate or trust matters. A non-exclusive list of products or services that are not unique to an estate or trust, and therefore are subject to the 2-percent floor, includes those rendered in connection with: custody or management of property; advice on investing for total return; gift tax returns; the defense of claims by creditors of the decedent or grantor; and the purchase, sale, maintenance, repair, insurance or management of non-trade or business property.

(c) *"Bundled fees".* If an estate or a non-grantor trust pays a single fee, commission or other expense for both costs that are unique to estates and trusts and costs that are not, then the estate or non-grantor trust must identify the portion (if any) of the legal, accounting, investment advisory, appraisal or other fee, commission or expense that is unique to estates and trusts and is thus not subject to the 2-percent floor. The taxpayer must use any reasonable method to allocate the single fee, commission or expense between the costs unique to estates and trusts and other costs.

(d) *Effective/applicability date.* These regulations are proposed to be effective for payments made after the date final regulations are published in **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 26, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 27, 2007, 72 F.R. 41243)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-72

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007

Name	Address	Designation	Date of Reinstatement
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007

Name	Address	Designation	Date of Suspension
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007

Name	Address	Designation	Date of Suspension
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007

Name	Address	Designation	Date of Suspension
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–76

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on September 4, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or

omissions of the organization that were the basis for revocation.

Progressive Services, Inc.
Norman, OK
Harold Binstein Humanitarian Fund
Chicago, IL

Say No to Drugs
Greenville, TX
Shamrock Boxing, Inc.
Covington, KY
National Home Foundation, Inc.
Rockville, MD

Business & Nonprofit Center
of Eastern Madera County
Fresno, CA

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 408A.—Roth IRAs

26 CFR 1.408A–1: Roth IRAs in general.
26 CFR 1.408(q)–1: Deemed IRAs in qualified employer plans.

Rev. Rul. 2007–58 expands the list of entities that are treated as "qualified pension or retirement plans" within the meaning of section 1.817–5(f)(3)(iii). See Rev. Rul. 2007-58, page 562.

Section 415.—Limitations on Benefits and Contributions Under Qualified Plans

Rev. Rul. 2007–58 expands the list of entities that are treated as "qualified pension or retirement plans" within the meaning of section 1.817–5(f)(3)(iii). See Rev. Rul. 2007-58, page 562.

Section 457.—Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations

Rev. Rul. 2007–58 expands the list of entities that are treated as "qualified pension or retirement plans" within the meaning of section 1.817–5(f)(3)(iii). See Rev. Rul. 2007-58, page 562.

Section 817.—Treatment of Variable Contracts

26 CFR 1.817–5: Diversification requirements for variable annuity, endowment, and life insurance contracts.
(Also §§ 408(p), 408(q), 408A, 415(m), 457(f).)

Qualified pension or retirement plan. This ruling supplements Rev. Rul. 94–62, 1994–2 C.B. 164, by expanding the list of entities that are treated as "qualified pension or retirement plans" within the meaning of regulations section 1.817–5(f)(3)(iii). Rev. Rul 94–62 supplemented.

Rev. Rul. 2007–58

This revenue ruling supplements Rev. Rul. 94–62, 1994–2 C.B. 164, by listing additional arrangements that each qualify as a "qualified pension or retirement plan" for purposes of § 1.817–5(f)(3)(iii) of the Income Tax Regulations.

BACKGROUND

Under section 817(h) of the Internal Revenue Code, a segregated asset account upon which a variable annuity or life insurance contract is based must be adequately diversified in order for the variable contract to be treated as an annuity under § 72 or as a life insurance contract under § 7702. Section 817(h)(4) and § 1.817–5(f) provide that in certain cases diversification may be satisfied under a "look-through" rule. If the look-through rule applies with respect to a beneficial interest in a regulated investment company, for example, the diversification requirements are applied by taking into account the assets held by the regulated investment company. One of the requirements for applying the look-through rule under § 1.817–5(f)(2)(i) is that all of the beneficial interests in a regulated investment company, partnership or trust be held by one or more insurance companies. For purposes of determining whether this requirement is satisfied, § 1.817–5(f)(3)(iii) provides that beneficial interests held by the trustee of a qualified pension or retirement plan are disregarded.

Rev. Rul. 94–62 provides that, solely for purposes of § 1.817–5(f)(3)(iii), the term "qualified pension or retirement plan" includes the following arrangements:

1. A plan described in § 401(a) that includes a trust exempt from tax under § 501(a);
2. An annuity plan described in § 403(a);
3. An annuity contract described in § 403(b), including a custodial account described in § 403(b)(7);
4. An individual retirement account described in § 408(a);
5. An individual retirement annuity described in § 408(b);
6. A governmental plan within the meaning of § 414(d) or an eligible deferred compensation plan within the meaning of § 457(b);
7. A simplified employee pension of an employer that satisfies the requirements of § 408(k);
8. A plan described in § 501(c)(18);
9. Any other trust, plan, account, contract, or annuity that the Internal Revenue Service has determined in a letter ruling to be within the scope of § 1.817–5(f)(3)(iii).

Whether an arrangement is described in § 1.817–5(f)(3)(iii) is based on the meaning and purpose of §§ 817 and 818. Since the issuance of Rev. Rul. 94–62, the Service has determined that certain additional arrangements may be treated as "qualified pension or retirement plans" for purposes of § 1.817–(5)(f)(3)(iii).

HOLDING

In addition to the nine arrangements identified in Rev. Rul. 94–62 and solely for purposes of § 1.817–5(f)(3)(iii), the term "qualified pension or retirement plan" includes the following five arrangements: a simple retirement account described in § 408(p); a deemed IRA described in § 408(q); a Roth IRA described in § 408A; a § 415(m) plan that is also a "governmental plan" within the meaning of § 414(d); and a § 457(f) plan that has as its sponsor either (i) a charitable organization described in § 818(a)(4), or (ii) a governmental organization described in § 818(a)(4), whose employees are described in § 403(b)(1)(A)(ii)). Accordingly, the list of arrangements that are treated as "qualified pension or retirements plans" within the meaning of § 1.817–5(f)(3)(iii) is supplemented to read as follows:

1. A plan described in § 401(a) that includes a trust exempt from tax under § 501(a);
2. An annuity plan described in § 403(a);
3. An annuity contract described in § 403(b), including a custodial account described in § 403(b)(7);
4. An individual retirement account described in § 408(a);
5. An individual retirement annuity described in § 408(b);
6. A governmental plan within the meaning of § 414(d) or an eligible deferred compensation plan within the meaning of § 457(b);

7. A simplified employee pension of an employer that satisfies the requirements of § 408(k);

8. A plan described in § 501(c)(18);

9. A simple retirement account described in § 408(p);

10. A deemed IRA described in § 408(q);

11. A Roth IRA described in § 408A;

12. A § 415(m) plan that is also a "governmental plan" within the meaning of § 414(d);

13. A § 457(f) plan that has as its sponsor either (i) a charitable organization described in § 818(a)(4), or (ii) a governmental organization described in § 818(a)(4), whose employees are described in § 403(b)(1)(A)(ii); and

14. Any other trust, plan, account, contract, or annuity that the Internal Revenue Service has determined in a letter ruling to be within the scope of § 1.817–5(f)(3)(iii).

EFFECT ON OTHER REVENUE RULING(S)

Rev. Rul. 94–62 is *supplemented.*

DRAFTING INFORMATION

The principal author of this revenue ruling is Melissa S. Luxner of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Melissa S. Luxner at (202) 622–3970 (not a toll-free call).

Section 2642.—Inclusion Ratio

26 CFR 26.2642–6: Qualified severance.

T.D. 9348

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 26, and 602

Qualified Severance of a Trust for Generation-Skipping Transfer (GST) Tax Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the qualified severance of a trust for generation-skipping transfer (GST) tax purposes under section 2642(a)(3) of the Internal Revenue Code (Code), which was added to the Code by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The regulations will affect trusts that are subject to the GST tax.

DATES: *Effective Date:* The regulations are effective August 2, 2007.

Applicability Date: For dates of applicability, see §26.2642–6(k)(1) and §26.2642–6(k)(2).

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels, (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1902.

The collection of information in these final regulations is in §26.2642–6(e). This information is requested by the IRS to identify whether a trust is exempt from the GST tax. This information is required to determine whether the amount of tax has been calculated correctly. The respondents are trustees of trusts that are being severed.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

The estimated average annual burden per respondent / recordkeeper is .5 hours per respondent. Comments concerning the accuracy of this burden estimate should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224 and the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 2642(a)(3) was added to the Internal Revenue Code by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Public Law 107–16 (115 Stat. 38 (2001)). Under section 2642(a)(3), if a trust is divided into two or more trusts in a "qualified severance," the resulting trusts will be recognized as separate trusts for GST tax purposes. In many cases, a qualified severance of a trust will facilitate the most efficient and effective use of the transferor's GST tax exemption. The GST tax exemption is each person's lifetime exemption that may be allocated to a generation-skipping transfer. If the transfer is made in trust, allocation of the donor's GST tax exemption reduces the trust's inclusion ratio, which in turn determines the amount of GST tax imposed on any generation-skipping transfer made with regard to the trust.

On August 24, 2004, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–145987–03, 2004–2 C.B. 519 [69 FR 51967]), providing rules under section 2642(a)(3) regarding the qualified severance of a trust for GST tax purposes. The IRS received written and oral comments responding to the notice of proposed rulemaking. No public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding proposed regulations are removed. The comments and revisions to the proposed regulations are discussed below. In addition, additional proposed regulations (REG–128843–05) are being issued contemporaneously with these final regulations in order to respond to certain comments that the Treasury Department and the IRS believe merit further consideration in proposed regulations.

Summary of Comments

The proposed regulations take the position that the severance rules contained in §26.2654–1(b) of the regulations were superseded by the enactment of section 2642(a)(3), and therefore that §26.2654–1(b) is no longer effective. However, many commentators noted that sections 2654(b) and 2642(a)(3) address different situations, and they suggested that section 2642(a)(3) was intended to supplement, rather than to replace, section 2654(b), and to thereby provide more flexibility in severing trusts for GST tax purposes. The commentators noted that section 2642(a)(3) qualified severances are effective prospectively from the date of severance and thus, that section only addresses severances that typically would occur after an irrevocable trust (whether *inter vivos* or testamentary) has been in existence for a period of time. In contrast, §26.2654–1(b) addresses only severances of testamentary trusts and revocable *inter vivos* trusts included in the transferor's gross estate, and a severance satisfying §26.2654–1(b) is effective retroactively to the date of death. Section 26.2654–1(b) provides for the recognition of severances of separate shares of such trusts, and of discretionary severances that, although not provided for in the governing instrument, are necessary to fully utilize available tax benefits (for example, the reverse qualified terminable interest property election under section 2652(a)(3)). To fulfill the purpose of these severances (generally, efficient utilization and allocation of the decedent's GST exemption), the severance must be effective retroactive to the date of death. Thus, section 2642(a)(3) and §26.2654–1(b) address different circumstances.

In response to these comments, the final regulations do not supersede §26.2654–1(b). Rather, §26.2654–1(b) is retained, but, as explained hereafter, is proposed to be amended as described in a notice of proposed rulemaking issued contemporaneously with these final regulations. Subject to those proposed changes, §26.2654–1(b) will continue to provide rules for mandatory and discretionary severances of trusts includible in the transferor's gross estate, effective retroactively to the transferor's date of death. The final regulations under §26.2642–6 generally provide rules for the qualified severance of a trust (whether or not includible in the transferor's gross estate) if the severance will be effective only prospectively from the date of severance.

One commentator requested that the regulations provide that separate trusts, created as the result of a mandated division of a single trust that is effective under state law, be recognized prospectively as separate trusts for certain GST tax purposes, even if the severance does not satisfy the requirements of a qualified severance. This comment will be addressed in the proposed regulations under section 2642, issued contemporaneously with these final regulations.

One commentator requested that the regulations provide additional flexibility in severing a trust that has an inclusion ratio between zero and one. Specifically, the commentator requested that the final regulations permit the qualified severance of a trust into one or more separate resulting trusts, as long as one or more of the resulting trusts, in the aggregate, would receive a fractional share of the total value of the original trust's assets that equals the applicable fraction of the original trust. In such a qualified severance, the resulting trust or trusts receiving this fractional share would each have an inclusion ratio of zero, and each of the other resulting trusts would have an inclusion ratio of one. This comment will be addressed in the proposed regulations under section 2642, issued contemporaneously with these final regulations.

In response to comments, the final regulations continue to require that, in notifying the IRS of the severance of a trust, the words "Qualified Severance" should appear at the top of Form 706–GS(T), *"Generation-Skipping Transfer Tax Return For Terminations,"* but the use of red ink for that purpose is not required.

One commentator questioned the requirement in the proposed regulations that any non-*pro rata* funding of trusts resulting from a qualified severance must be based on the value of the trust assets as of the date of funding. The commentator pointed out that, in many cases, the funding of trusts resulting from a qualified severance will take place over a period of time, rather than on one specific date. Accordingly, under the final regulations, the non-*pro rata* funding of trusts resulting from a qualified severance must be achieved by applying the appropriate fraction or percentage to the total value of the trust assets as of the "date of severance." The term "date of severance" is defined as the date selected for determining the value of the trust assets (whether selected on a discretionary basis or by a court order), provided that funding is commenced immediately and occurs within a reasonable time before or after the selected date of severance. For this purpose, a reasonable time may differ depending upon the type of asset involved, but in no event may be more than 90 days.

Several commentators requested that the regulations address the severance of a trust that was irrevocable on September 25, 1985, but with respect to which an addition was made to the trust after September 25, 1985. For purposes of determining the inclusion ratio with respect to such a trust, §26.2601–1(b)(1)(iv)(A) provides that the trust is deemed to consist of two portions, one portion not subject to GST tax (the non-chapter 13 portion) with an inclusion ratio of zero, and one portion subject to GST tax (the chapter 13 portion) with an inclusion ratio determined under section 2642. In response to these comments, the final regulations provide guidance regarding a qualified severance of the chapter 13 portion of these trusts.

The proposed regulations include a mandatory reporting requirement, without which a severance would not constitute a qualified severance. One commentator noted that, in some situations, it may be advantageous to sever a trust but to avoid qualification under section 2642(a)(3) as a qualified severance. The Treasury Department and the IRS believe that the qualified severance rules were not intended to be optional; that is, able to be employed or avoided depending upon the tax consequences of a particular severance. Therefore, under the final regulations, the reporting provisions do not constitute a requirement for qualified severance status, but each severance should be reported to ensure that the provisions of Chapter 13 of the Code may be properly applied with regard to the trusts.

One commentator noted that §1.1001–1(h)(1) of the proposed regulations provides favorable income tax treatment only with respect to a qualified severance. The commentator re-

quested that the regulations also address the income tax treatment of all other trust modifications and severances. The commentator noted that the failure to address, for example, the income tax consequences of severances that are not qualified severances for GST tax purposes implies that such severances are taxable events for income tax purposes. In response to these comments, the category of severances to which §1.1001–1(h)(1) will apply has been broadened. No inference should be drawn with respect to the income tax consequences under section 1001 of any severance that is not described in §1.1001–1(h)(1).

Commentators noted that some qualified severances may result in a taxable termination or taxable distribution, for example, if after the severance, one of the resulting trusts is a skip person. The final regulations clarify that, if the qualified severance itself results in a GST taxable event, the taxable event is treated as occurring immediately after the severance. As a result, if the resulting trust that is a skip person is also the trust that has a zero inclusion ratio after the severance, then no GST tax will result from the taxable event that is deemed to occur after the severance. An example was added illustrating this rule.

Finally, in response to comments, an example has been added addressing the qualified severance rules in the case of a trust where the beneficiary is granted a contingent testamentary general power of appointment that is dependent upon the trust's inclusion ratio.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the collection of information imposed by this regulation is not significant as reflected in the estimated burden of information collection for, which is 0.5 hours per respondent, and that few trustees are likely to be small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these final regulations is Mayer R. Samuels, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. Other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 26 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §1.1001–1, paragraph (h) is added to read as follows:

§1.1001–1 Computation of gain or loss.

* * * * *

(h) *Severances of trusts*—(1) *In general.* The severance of a trust (including without limitation a severance that meets the requirements of §26.2642–6 or of §26.2654–1(b) of this chapter) is not an exchange of property for other property differing materially either in kind or in extent if—

(i) An applicable state statute or the governing instrument authorizes or directs the trustee to sever the trust; and

(ii) Any non-*pro rata* funding of the separate trusts resulting from the severance (including non-*pro rata* funding as described in §26.2642–6(d)(4) or §26.2654–1(b)(1)(ii)(C) of this chapter), whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or the governing instrument.

(2) *Effective/applicability date.* This paragraph (h) applies to severances occurring on or after August 2, 2007. Taxpayers may apply this paragraph (h) to severances occurring on or after August 24, 2004, and before August 2, 2007.

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Par. 3. The authority citation for part 26 is amended by adding an entry in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 26.2642–6 also issued under 26 U.S.C. 2642. * * *

Par. 4. In §26.2600–1, the table of contents is amended by adding entries for §§26.2642–6 and 26.2654–1 to read as follows:

§26.2600–1 Table of contents.

* * * * *

§26.2642–6 Qualified severance.

(a) In general.
(b) Qualified severance defined.
(c) Effective date of qualified severance.
(d) Requirements for a qualified severance.
(e) Reporting a qualified severance.
(f) Time for making a qualified severance.
(g) Trusts that were irrevocable on September 25, 1985.
(1) In general.
(2) Trusts in receipt of a post-September 25, 1985, addition.
(h) [Reserved]
(i) [Reserved]
(j) Examples.
(k) Effective date.
(1) In general.
(2) Transition rule.

* * * * *

§26.2654–1 Certain trusts treated as separate trusts.

* * * * *

(c) Cross reference.

* * * * *

Par. 5. Section 26.2642–6 is added to read as follows:

§26.2642–6 Qualified severance.

(a) *In general.* If a trust is divided in a qualified severance into two or more trusts, the separate trusts resulting from the severance will be treated as separate trusts for generation-skipping transfer (GST) tax purposes and the inclusion ratio of each new resulting trust may differ from the inclusion ratio of the original trust. Because the post-severance resulting trusts are treated as separate trusts for GST tax purposes, certain actions with respect to one resulting trust will generally have no GST tax impact with respect to the other resulting trust(s). For example, GST exemption allocated to one resulting trust will not impact on the inclusion ratio of the other resulting trust(s); a GST tax election made with respect to one resulting trust will not apply to the other resulting trust(s); the occurrence of a taxable distribution or termination with regard to a particular resulting trust will not have any GST tax impact on any other trust resulting from that severance. In general, the rules in this section are applicable only for purposes of the GST tax and are not applicable in determining, for example, whether the resulting trusts may file separate income tax returns or whether the severance may result in a gift subject to gift tax, may cause any trust to be included in the gross estate of a beneficiary, or may result in a realization of gain for purposes of section 1001. See §1.1001–1(h) of this chapter for rules relating to whether a qualified severance will constitute an exchange of property for other property differing materially either in kind or in extent.

(b) *Qualified severance defined.* A qualified severance is a division of a trust (other than a division described in §26.2654–1(b)) into two or more separate trusts that meets each of the requirements in paragraph (d) of this section.

(c) *Effective date of qualified severance.* A qualified severance is applicable as of the date of the severance, as defined in §26.2642–6(d)(3), and the resulting trusts are treated as separate trusts for GST tax purposes as of that date.

(d) *Requirements for a qualified severance.* For purposes of this section, a qualified severance must satisfy each of the following requirements:

(1) The single trust is severed pursuant to the terms of the governing instrument, or pursuant to applicable local law.

(2) The severance is effective under local law.

(3) The date of severance is either the date selected by the trustee as of which the trust assets are to be valued in order to determine the funding of the resulting trusts, or the court-imposed date of funding in the case of an order of the local court with jurisdiction over the trust ordering the trustee to fund the resulting trusts on or as of a specific date. For a date to satisfy the definition in the preceding sentence, however, the funding must be commenced immediately upon, and funding must occur within a reasonable time (but in no event more than 90 days) after, the selected valuation date.

(4) The single trust (original trust) is severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively. For this purpose, the fraction or percentage may be determined by means of a formula (for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST tax exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance). The severance of a trust based on a pecuniary amount does not satisfy this requirement. For example, the severance of a trust is not a qualified severance if the trust is divided into two trusts, with one trust to be funded with $1,500,000 and the other trust to be funded with the balance of the original trust's assets. With respect to the particular assets to be distributed to each resulting trust, each resulting trust may be funded with the appropriate fraction or percentage (*pro rata* portion) of each asset held by the original trust. Alternatively, the assets may be divided among the resulting trusts on a non-*pro rata* basis, based on the fair market value of the assets on the date of severance. However, if funded on a non-*pro rata* basis, each resulting trust must be funded by applying the appropriate fraction or percentage to the total fair market value of the trust assets as of the date of severance.

(5) The terms of the resulting trusts must provide, in the aggregate, for the same succession of interests of beneficiaries as are provided in the original trust. This requirement is satisfied if the beneficiaries of the separate resulting trusts and the interests of the beneficiaries with respect to the separate trusts, when the separate trusts are viewed collectively, are the same as the beneficiaries and their respective beneficial interests with respect to the original trust before severance. With respect to trusts from which discretionary distributions may be made to any one or more beneficiaries on a non-*pro rata* basis, this requirement is satisfied if—

(i) The terms of each of the resulting trusts are the same as the terms of the original trust (even though each permissible distributee of the original trust is not a beneficiary of all of the resulting trusts);

(ii) Each beneficiary's interest in the resulting trusts (collectively) equals the beneficiary's interest in the original trust, determined by the terms of the trust instrument or, if none, on a per-capita basis. For example, in the case of the severance of a discretionary trust established for the benefit of A, B, and C and their descendants with the remainder to be divided equally among those three families, this requirement is satisfied if the trust is divided into three separate trusts of equal value with one trust established for the benefit of A and A's descendants, one trust for the benefit of B and B's descendants, and one trust for the benefit of C and C's descendants;

(iii) The severance does not shift a beneficial interest in the trust to any beneficiary in a lower generation (as determined under section 2651) than the person or persons who held the beneficial interest in the original trust; and

(iv) The severance does not extend the time for the vesting of any beneficial interest in the trust beyond the period provided for in (or applicable to) the original trust.

(6) In the case of a qualified severance of a trust with an inclusion ratio as defined in §26.2642–1 of either one or zero, each trust resulting from the severance will have an inclusion ratio equal to the inclusion ratio of the original trust.

(7) In the case of a qualified severance occurring after GST tax exemption has been allocated to the trust (whether by an affirmative allocation, a deemed allocation, or an automatic allocation pursuant

to the rules contained in section 2632), if the trust has an inclusion ratio as defined in §26.2642–1 that is greater than zero and less than one, then the trust must be severed initially into two trusts. One resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction, as defined in §26.2642–1(b) and (c), used to determine the inclusion ratio of the original trust immediately before the severance. The other resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the excess of one over the fractional share described in the preceding sentence. The trust receiving the fractional share equal to the applicable fraction shall have an inclusion ratio of zero, and the other trust shall have an inclusion ratio of one. If the applicable fraction with respect to the original trust is .50, then, with respect to the two equal trusts resulting from the severance, the Trustee may designate which of the resulting trusts will have an inclusion ratio of zero and which will have an inclusion ratio of one. Each separate trust resulting from the severance then may be further divided in accordance with the rules of this section. See paragraph (j), *Example 7* of this section.

(e) *Reporting a qualified severance*—(1) *In general.* A qualified severance is reported by filing Form 706–GS(T), *"Generation-Skipping Transfer Tax Return For Terminations,"* (or such other form as may be provided from time to time by the Internal Revenue Service (IRS) for the purpose of reporting a qualified severance). Unless otherwise provided in the applicable form or instructions, the IRS requests that the filer write "Qualified Severance" at the top of the form and attach a Notice of Qualified Severance (Notice). The return and attached Notice should be filed by April 15th of the year immediately following the year during which the severance occurred or by the last day of the period covered by an extension of time, if an extension of time is granted, to file such form.

(2) *Information concerning the original trust.* The Notice should provide, with respect to the original trust that was severed—

(i) The name of the transferor;

(ii) The name and date of creation of the original trust;

(iii) The tax identification number of the original trust; and

(iv) The inclusion ratio before the severance.

(3) *Information concerning each new trust.* The Notice should provide, with respect to each of the resulting trusts created by the severance—

(i) The name and tax identification number of the trust;

(ii) The date of severance (within the meaning of paragraph (c) of this section);

(iii) The fraction of the total assets of the original trust received by the resulting trust;

(iv) Other details explaining the basis for the funding of the resulting trust (a fraction of the total fair market value of the assets on the date of severance, or a fraction of each asset); and

(v) The inclusion ratio.

(f) *Time for making a qualified severance.* (1) A qualified severance of a trust may occur at any time prior to the termination of the trust. Thus, provided that the separate resulting trusts continue in existence after the severance, a qualified severance may occur either before or after—

(i) GST tax exemption has been allocated to the trust;

(ii) A taxable event has occurred with respect to the trust; or

(iii) An addition has been made to the trust.

(2) Because a qualified severance is effective as of the date of severance, a qualified severance has no effect on a taxable termination as defined in section 2612(a) or a taxable distribution as defined in section 2612(b) that occurred prior to the date of severance. A qualified severance shall be deemed to occur before a taxable termination or a taxable distribution that occurs by reason of the qualified severance. See paragraph (j) *Example 8* of this section.

(g) *Trusts that were irrevocable on September 25, 1985*—(1) *In general.* See §26.2601–1(b)(4) for rules regarding severances and other actions with respect to trusts that were irrevocable on September 25, 1985.

(2) *Trusts in receipt of a post-September 25, 1985, addition.* A trust described in §26.2601–1(b)(1)(iv)(A) that is deemed for GST tax purposes to consist of one separate share not subject to GST tax (the non-chapter 13 portion) with an inclusion ratio of zero, and one separate share subject to GST tax (the chapter 13 portion) with an inclusion ratio determined under section 2642, may be severed into two trusts in accordance with §26.2654–1(a)(3). One resulting trust will hold the non-chapter 13 portion of the original trust (the non-chapter 13 trust) and will not be subject to GST tax, and the other resulting trust will hold the chapter 13 portion of the original trust (the chapter 13 trust) and will have the same inclusion ratio as the chapter 13 portion immediately prior to the severance. The chapter 13 trust may be further divided in a qualified severance in accordance with the rules of this section. The non-chapter 13 trust may be further divided in accordance with the rules of §26.2601–1(b)(4).

(h) [Reserved].

(i) [Reserved].

(j) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. Succession of interests. T dies in 2006. T's will establishes a testamentary trust (Trust) providing that income is to be paid to T's sister, S, for her life. On S's death, one-half of the corpus is to be paid to T's child, C (or to C's estate if C fails to survive S), and one-half of the corpus is to be paid to T's grandchild, GC (or to GC's estate if GC fails to survive S). On the Form 706, "*United States Estate (and Generation-Skipping Transfer) Tax Return,*" filed for T's estate, T's executor allocates all of T's available GST tax exemption to other transfers and trusts, such that Trust's inclusion ratio is 1. Subsequent to filing the Form 706 in 2007 and in accordance with applicable state law, the trustee divides Trust into two separate trusts, Trust 1 and Trust 2, with each trust receiving 50 percent of the value of the assets of the original trust as of the date of severance. Trust 1 provides that trust income is to be paid to S for life with remainder to C or C's estate, and Trust 2 provides that trust income is to be paid to S for life with remainder to GC or GC's estate. Because Trust 1 and Trust 2 provide for the same succession of interests in the aggregate as provided in the original trust, the severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied.

Example 2. Succession of interests in discretionary trust. In 2006, T establishes Trust, an irrevocable trust providing that income may be paid from time to time in such amounts as the trustee deems advisable to any one or more members of the group consisting of T's children (A and B) and their respective descendants. In addition, the trustee may distribute corpus to any trust beneficiary in such amounts as the trustee deems advisable. On the death of the last to die of A and B, the trust is to terminate and the corpus is to be distributed in two equal shares, one share to the then-living descendants of each child, per stirpes. T elects, under section 2632(c)(5), to not have the automatic allocation rules contained in section 2632(c) apply with respect to T's transfers to Trust, and T does not otherwise allocate GST tax exemption with respect to Trust. As a result, Trust has an inclusion ratio of one. In 2008,

the trustee of Trust, pursuant to applicable state law, divides Trust into two equal but separate trusts, Trust 1 and Trust 2, each of which has terms identical to the terms of Trust except for the identity of the beneficiaries. Trust 1 and Trust 2 each has an inclusion ratio of one. Trust 1 provides that income is to be paid in such amounts as the trustee deems advisable to A and A's descendants. In addition, the trustee may distribute corpus to any trust beneficiary in such amounts as the trustee deems advisable. On the death of A, Trust 1 is to terminate and the corpus is to be distributed to the then-living descendants of A, per stirpes, but, if A dies with no living descendants, the principal will be added to Trust 2. Trust 2 contains identical provisions, except that B and B's descendants are the trust beneficiaries and, if B dies with no living descendants, the principal will be added to Trust 1. Trust 1 and Trust 2 in the aggregate provide for the same beneficiaries and the same succession of interests as provided in Trust, and the severance does not shift any beneficial interest to a beneficiary who occupies a lower generation than the person or persons who held the beneficial interest in Trust. Accordingly, the severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied.

Example 3. Severance based on actuarial value of beneficial interests. In 2004, T establishes Trust, an irrevocable trust providing that income is to be paid to T's child C during C's lifetime. Upon C's death, Trust is to terminate and the assets of Trust are to be paid to GC, C's child, if living, or, if GC is not then living, to GC's estate. T properly elects, under section 2632(c)(5), to not have the automatic allocation rules contained in section 2632(c) apply with respect to T's transfers to Trust, and T does not otherwise allocate GST tax exemption with respect to Trust. Thus, Trust has an inclusion ratio of one. In 2008, the trustee of Trust, pursuant to applicable state law, divides Trust into two separate trusts, Trust 1 for the benefit of C (and on C's death to C's estate), and Trust 2 for the benefit of GC (and on GC's death to GC's estate). The document severing Trust directs that Trust 1 is to be funded with an amount equal to the actuarial value of C's interest in Trust prior to the severance, determined under section 7520 of the Internal Revenue Code. Similarly, Trust 2 is to be funded with an amount equal to the actuarial value of GC's interest in Trust prior to the severance, determined under section 7520. Trust 1 and Trust 2 do not provide for the same succession of interests as provided under the terms of the original trust. Therefore, the severance is not a qualified severance.

Example 4. Severance of a trust with a 50% inclusion ratio. On September 1, 2006, T transfers $100,000 to a trust for the benefit of T's grandchild, GC. On a timely filed Form 709, "*United States Gift (and Generation-Skipping Transfer) Tax Return*," reporting the transfer, T allocates all of T's remaining GST tax exemption ($50,000) to the trust. As a result of the allocation, the applicable fraction with respect to the trust is .50 [$50,000 (the amount of GST tax exemption allocated to the trust) divided by $100,000 (the value of the property transferred to the trust)]. The inclusion ratio with respect to the trust is .50 [1 - .50]. In 2007, pursuant to authority granted under applicable state law, the trustee severs the trust into two trusts, Trust 1 and Trust 2, each of which is identical to the original trust and each of which receives a 50 percent fractional share of the total value of the original trust, valued as of the date of severance. Because the applicable fraction with respect to the original trust is .50 and the trust is severed into two equal trusts, the trustee may designate which resulting trust has an inclusion ratio of one, and which resulting trust has an inclusion ratio of zero. Accordingly, in the Notice of Qualified Severance reporting the severance, the trustee designates Trust 1 as having an inclusion ratio of zero, and Trust 2 as having an inclusion ratio of one. The severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied.

Example 5. Funding of severed trusts on a non-pro rata basis. T's will establishes a testamentary trust (Trust) for the benefit of T's descendants, to be funded with T's stock in Corporation A and Corporation B, both publicly traded stocks. T dies on May 1, 2004, at which time the Corporation A stock included in T's gross estate has a fair market value of $100,000 and the stock of Corporation B included in T's gross estate has a fair market value of $200,000. On a timely filed Form 706, T's executor allocates all of T's remaining GST tax exemption ($270,000) to Trust. As a result of the allocation, the applicable fraction with respect to Trust is .90 [$270,000 (the amount of GST tax exemption allocated to the trust) divided by $300,000 (the value of the property transferred to the trust)]. The inclusion ratio with respect to Trust is .10 [1 - .90]. On August 1, 2008, in accordance with applicable local law, the trustee executes a document severing Trust into two trusts, Trust 1 and Trust 2, each of which is identical to Trust. The instrument designates August 3, 2008, as the date of severance (within the meaning of paragraph (d)(3) of this section). The terms of the instrument severing Trust provide that Trust 1 is to be funded on a non-*pro rata* basis with assets having a fair market value on the date of severance equal to 90% of the value of Trust's assets on that date, and Trust 2 is to be funded with assets having a fair market value on the date of severance equal to 10% of the value of Trust's assets on that date. On August 3, 2008, the value of the Trust assets totals $500,000, consisting of Corporation A stock worth $450,000 and Corporation B stock worth $50,000. On August 4, 2008, the trustee takes all action necessary to transfer all of the Corporation A stock to Trust 1 and to transfer all of the Corporation B stock to Trust 2. On August 6, 2008, the stock transfers are completed and the stock is received by the appropriate resulting trust. Accordingly, Trust 1 is funded with assets having a value equal to 90% of the value of Trust as of the date of severance, August 3, 2008, and Trust 2 is funded with assets having a value equal to 10% of the value of Trust as of the date of severance. Therefore, the severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied. Trust 1 will have an inclusion ratio of zero and Trust 2 will have an inclusion ratio of one.

Example 6. [Reserved].

Example 7. Statutory qualified severance. T dies on October 1, 2004. T's will establishes a testamentary trust (Trust) to be funded with $1,000,000. Trust income is to be paid to T's child, S, for S's life. The trustee may also distribute trust corpus from time to time, in equal or unequal shares, for the benefit of any one or more members of the group consisting of S and T's three grandchildren (GC1, GC2, and GC3). On S's death, Trust is to terminate and the assets are to be divided equally among GC1, GC2, and GC3 (or their respective then-living descendants, per stirpes). On a timely filed Form 706, T's executor allocates all of T's remaining GST tax exemption ($300,000) to Trust. As a result of the allocation, the applicable fraction with respect to the trust is .30 [$300,000 (the amount of GST tax exemption allocated to the trust) divided by $1,000,000 (the value of the property transferred to the trust)]. The inclusion ratio with respect to the trust is .70 [1 - .30]. On June 1, 2007, the trustee determines that it is in the best interest of the beneficiaries to sever Trust to provide a separate trust for each of T's three grandchildren and their respective families. The trustee severs Trust into two trusts, Trust 1 and Trust 2, each with terms and beneficiaries identical to Trust and thus each providing that trust income is to be paid to S for life, trust principal may be distributed for the benefit of any or all members of the group consisting of S and T's grandchildren, and, on S's death, the trust is to terminate and the assets are to be divided equally among GC1, GC2, and GC3 (or their respective then-living descendants, per stirpes). The instrument severing Trust provides that Trust 1 is to receive 30% of Trust's assets and Trust 2 is to receive 70% of Trust's assets. Further, each such trust is to be funded with a *pro rata* portion of each asset held in Trust. The trustee then severs Trust 1 into three equal trusts, Trust GC1, Trust GC2, and Trust GC3. Each trust is named for a grandchild of T and provides that trust income is to be paid to S for life, trust principal may be distributed for the benefit of S and T's grandchild for whom the trust is named, and, on S's death, the trust is to terminate and the trust proceeds distributed to the respective grandchild for whom the trust is named. If that grandchild has predeceased the termination date, the trust proceeds are to be distributed to that grandchild's then-living descendants, per stirpes, or, if none, then equally to the other two trusts resulting from the severance of Trust 1. Each such resulting trust is to be funded with a *pro rata* portion of each Trust 1 asset. The trustee also severs Trust 2 in a similar manner, into Trust GC1(2), Trust GC2(2), and Trust GC3(2). The severance of Trust into Trust 1 and Trust 2, the severance of Trust 1 into Trust GC1, Trust GC2, Trust GC3, and the severance of Trust 2 into Trust GC1(2), Trust GC2(2) and Trust GC3(2), constitute qualified severances, provided that all other requirements of section 2642(a)(3) and this section are satisfied with respect to each severance. Trust GC1, Trust GC2, Trust GC3 will each have an inclusion ratio of zero and Trust GC1(2), Trust GC2(2), and Trust GC3(2) will each have an inclusion ratio of one.

Example 8. Qualified severance deemed to precede a taxable termination. In 2004, T establishes an *inter vivos* irrevocable trust (Trust) for a term of 10 years providing that Trust income is to be paid annually in equal shares to T's child C and T's grandchild GC (the child of another then-living child of T). If either C or GC dies prior to the expiration of the 10-year term, the deceased beneficiary's share of Trust's income is to be paid to that beneficiary's then-living descendants, per stirpes, for the balance of the trust term. At the expiration of the 10-year trust term, the corpus is to be distributed equally to C and GC; if either C or GC is not then living, then such decedent's share is to be distributed instead to such decedent's then-living descendants, per stirpes. T allocates T's

GST tax exemption to Trust such that Trust's applicable fraction is .50 and Trust's inclusion ratio is .50 [1-.50]. In 2006, pursuant to applicable state law, the trustee severs the trust into two equal trusts, Trust 1 and Trust 2. The instrument severing Trust provides that Trust 1 is to receive 50% of the Trust assets, and Trust 2 is to receive 50% of Trust's assets. Both resulting trusts are identical to Trust, except that each has different beneficiaries: C and C's descendants are designated as the beneficiaries of Trust 1, and GC and GC's descendants are designated as the beneficiaries of Trust 2. The severance constitutes a qualified severance, provided all other requirements of section 2642(a)(3) and this section are satisfied. Because the applicable fraction with respect to Trust is .50 and Trust was severed into two equal trusts, the trustee may designate which resulting trust has an inclusion ratio of one, and which has an inclusion ratio of zero. Accordingly, in the Notice of Qualified Severance reporting the severance, the trustee designates Trust 1 as having an inclusion ratio of one, and Trust 2 as having an inclusion ratio of zero. Because Trust 2 is a skip person under section 2613, the severance of Trust resulting in the distribution of 50% of Trust's corpus to Trust 2 would constitute a taxable termination or distribution (as described in section 2612(a)) of that 50% of Trust for GST tax purposes, but for the rule that a qualified severance is deemed to precede a taxable termination that is caused by the qualified severance. Thus, no GST tax will be due with regard to the creation and funding of Trust 2 because the inclusion ratio of Trust 2 is zero.

Example 9. [Reserved].

Example 10. Beneficiary's interest dependent on inclusion ratio. On August 8, 2006, T transfers $1,000,000 to Trust and timely allocates $400,000 of T's remaining GST tax exemption to Trust. As a result of the allocation, the applicable fraction with respect to Trust is .40 [$400,000 divided by $1,000,000] and Trust's inclusion ratio is .60 [1 - .40]. Trust provides that all income of Trust will be paid annually to C, T's child, for life. On C's death, the corpus is to pass in accordance with C's exercise of a testamentary limited power to appoint the corpus of Trust to C's lineal descendants. However, Trust provides that if, at the time of C's death, Trust's inclusion ratio is greater than zero, then C may also appoint that fraction of the trust corpus equal to the inclusion ratio to the creditors of C's estate. On May 3, 2008, pursuant to authority granted under applicable state law, the trustee severs Trust into two trusts. Trust 1 is funded with 40% of Trust's assets, and Trust 2 is funded with 60% of Trust's assets in accordance with the requirements of this section. Both Trust 1 and Trust 2 provide that all income of Trust will be paid annually to C during C's life. On C's death, Trust 1 corpus is to pass in accordance with C's exercise of a testamentary limited power to appoint the corpus to C's lineal descendants. Trust 2 is to pass in accordance with C's exercise of a testamentary power to appoint the corpus of Trust to C's lineal descendants and to the creditors of C's estate. The severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied. No additional contribution or allocation of GST tax exemption is made to either Trust 1 or Trust 2 prior to C's death. Accordingly, the inclusion ratio with respect to Trust 1 is zero. The inclusion ratio with respect to Trust 2 is one until C's death, at which time C will become the transferor of Trust 2 for GST tax purposes. (Some or all of C's GST tax exemption may be allocated to Trust 2 upon C's death.)

Example 11. Date of severance. Trust is an irrevocable trust that has both skip person and non-skip person beneficiaries. Trust holds two parcels of real estate, Property A and Property B, stock in Company X, a publicly traded company, and cash. On June 16, 2008, the local court with jurisdiction over Trust issues an order, pursuant to the trustee's petition authorized under state law, severing Trust into two resulting trusts of equal value, Trust 1 and Trust 2. The court order directs that Property A will be distributed to Trust 1 and Property B will be distributed to Trust 2, and that an appropriate amount of stock and cash will be distributed to each trust such that the total value of property distributed to each trust as of the date of severance will be equal. The court order does not mandate a particular date of funding. Trustee receives notice of the court order on June 24, and selects July 16, 2008, as the date of severance. On June 26, 2008, Trustee commences the process of transferring title to Property A and Property B to the appropriate resulting trust(s), which process is completed on July 8, 2008. Also on June 26, the Trustee hires a professional appraiser to value Property A and Property B as of the date of severance and receives the appraisal report on Friday, October 3, 2008. On Monday, October 6, 2008, Trustee commences the process of transferring to Trust 1 and Trust 2 the appropriate amount of Company X stock valued as of July 16, 2008, and that transfer (as well as the transfer of Trust's cash) is completed by October 9, 2008. Under the facts presented, the funding of Trust 1 and Trust 2 occurred within 90 days of the date of severance selected by the trustee, and within a reasonable time after the date of severance taking into account the nature of the assets involved and the need to obtain an appraisal. Accordingly, the date of severance for purposes of this section is July 16, 2008, the resulting trusts are to be funded based on the value of the original trust assets as of that date, and the severance is a qualified severance assuming that all other requirements of section 2642(a)(3) and this section are met. (However, if Trust had contained only marketable securities and cash, then in order to satisfy the reasonable time requirement, the stock transfer would have to have been commenced, and generally completed, immediately after the date of severance, and the cash distribution would have to have been made at the same time.)

(k) *Effective date*—(1) *In general*. This section applies to severances occurring on or after August 2, 2007.

(2) *Transition rule.* In the case of a qualified severance occurring after December 31, 2000, and before August 2, 2007, taxpayers may rely on any reasonable interpretation of section 2642(a)(3) as long as reasonable notice concerning the qualified severance and identification of the trusts involved has been given to the IRS. For this purpose, the proposed regulations (69 FR 51967) are treated as a reasonable interpretation of the statute. For purposes of the reporting provisions of §26.2642–6(e), notice to the IRS should be mailed by the due date of the gift tax return (including extensions granted) for gifts made during the year in which the severance occurred. If no gift tax return is filed, notice to the IRS should be mailed by April 15th of the year immediately following the year during which the severance occurred. For severances occurring between December 31, 2000, and January 1, 2007, notification should be mailed to the IRS as soon as reasonably practicable after August 2, 2007, if sufficient notice has not already been given.

Par. 6. Section 26.2654–1 is amended by adding paragraphs (b)(4) *Example 3* and (c) to read as follows:

§26.2654–1 Certain trusts treated as separate trusts.

* * * * *

(b) * * *

(4) *Examples.* * * *

Example 3. Formula severance. T's will establishes a testamentary marital trust (Trust) that meets the requirements of qualified terminable interest property (QTIP) if an election under section 2056(b)(7) is made. Trust provides that all trust income is to be paid to T's spouse for life. On the spouse's death, the trust corpus is to be held in further trust for the benefit of T's then-living descendants. On T's date of death in January of 2004, T's unused GST tax exemption is $1,200,000, and T's will includes $200,000 of bequests to T's grandchildren. Prior to the due date for filing the Form 706, "*United States Estate (and Generation-Skipping Transfer) Tax Return*," for T's estate, T's executor, pursuant to applicable state law, divides Trust into two separate trusts, Trust 1 and Trust 2. Trust 1 is to be funded with that fraction of the Trust assets, the numerator of which is $1,000,000, and the denominator of which is the value of the Trust assets as finally determined for federal estate tax purposes. Trust 2 is to be funded with that fraction of the Trust assets, the numerator of which is the excess of the Trust assets over $1,000,000, and the denominator of which is the value of the Trust assets as finally determined for federal estate tax purposes. On the Form 706 filed for the estate, T's executor makes a QTIP election under section 2056(b)(7) with respect to Trust 1 and Trust 2 and a "reverse" QTIP election under section 2652(a)(3) with respect to Trust 1. Further, T's executor allocates $200,000 of T's available GST tax exemption to the bequests to T's grandchildren, and the balance of T's exemption ($1,000,000) to Trust 1. If the requirements of paragraph (b) of this section are otherwise satisfied, Trust 1 and Trust 2 are recognized as separate trusts for GST tax purposes. Accordingly, the "reverse" QTIP election and allocation of GST tax exemption with respect to Trust 1 are recognized and effective for generation-skipping transfer tax purposes.

(c) *Cross reference.* For rules applicable to the qualified severance of trusts

(whether or not includible in the transferor's gross estate), see §26.2642–6.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is amended by adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1001–1	1545–1902
* * * * *	
26.2642–6	1545–1902
* * * * *	
26.2654–1	1545–1902
* * * * *	

Linda E. Stiff,
Acting Deputy Commissioner for Services and Enforcement.

Approved July 24, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 1, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 2, 2007, 72 F.R. 42291)

Section 4081.—Imposition of Tax

26 CFR 48.4081–1: Taxable fuel; definitions.

T.D. 9346

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 48 and 602

Entry of Taxable Fuel

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the tax on the entry of taxable fuel into the United States. The final regulations affect enterers of taxable fuel, other importers of record, and certain sureties.

DATES: *Effective Date:* These regulations are effective July 27, 2007.

Applicability Dates: For dates of applicability, see §§48.4081–1(f) and 48.4081–3(j).

FOR FURTHER INFORMATION CONTACT: Celia Gabrysh at (202) 622–3130 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1897. The collection of information in these final regulations is in §48.4081–3(c)(2)(iii) and (iv). This collection of information allows certain importers of record and sureties to avoid liability for the tax on the entry of taxable fuel into the United States.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The estimated annual burden per respondent and/or recordkeeper varies from 15 minutes to 2.25 hours, depending on individual circumstances, with an estimated average of 1.25 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document amends the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) to provide rules relating to the tax that section 4081 of the Internal Revenue Code (Code) imposes on the entry of taxable fuel into the United States. On July 30, 2004, a temporary regulation (T.D. 9145, 2004–2 C.B. 464 [69 FR 45587]) relating to this topic was published in the **Federal Register**. A notice of proposed rulemaking (REG–120616–03, 2004–2 C.B. 474 [69 FR 45631]) cross-referencing the temporary regulations was published in the **Federal Register** on the same day. Written

and electronic comments were received and a public hearing was held on January 12, 2005. After considering the written comments and the comments made at the public hearing, the proposed regulations are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed.

The temporary and proposed regulations. Effective September 28, 2004, the temporary regulations provide that the importer of record (under Customs law) of taxable fuel is jointly and severally liable with the enterer for the tax imposed on the entry of taxable fuel if the importer of record is not the enterer (that is, the importer of record is a customs broker engaged by the enterer) and the enterer is not a taxable fuel registrant. Under the law in effect before September 28, 2004, an importer of record's Customs bond could have been charged for any unpaid tax imposed on the entry of fuel imported under the bond. The preamble of the temporary regulations stated, however, that the IRS would not charge the Customs bond for the tax imposed on an entry of fuel occurring before September 28, 2004. In addition, the temporary regulations provide that the Customs bond posted with respect to the importation of fuel will not be charged for the tax imposed on an entry of fuel occurring after September 27, 2004, if the enterer is a taxable fuel registrant or the surety believes, based on the enterer's certification, that the enterer is a taxable fuel registrant.

Public comments. One commentator that represents an association of road builders supported the proposed and temporary regulations, calling them one of a series of important initiatives necessary to combat fuel tax evasion and finance the Highway Trust Fund.

Several commentators that represent tribal interests in the state of New York opposed the regulations. They maintained that the regulations will cause fuel prices to increase at service stations located on tribal reservations. These higher fuel prices will reduce sales and result in the loss of several hundred tribal jobs. In addition, a reduction in sales at these stations would cause a decrease in receipts from the tribal tax on fuel sold on the reservations. This tax funds general tribal government services, including police, health, and welfare programs.

Many of these commentators also suggested that the Treasury Department and the IRS failed to comply with section 5 of Executive Order 13175 (65 FR 6724) and Executive Order 12866 (58 FR 51735), which generally requires each Federal agency to consult with tribal officials before the promulgation of any regulation that "has tribal implications" or that "imposes substantial direct compliance costs on Indian tribal governments."

The final regulations. This Treasury decision adopts the proposed rules as final regulations without substantive change. Because the cross-reference notice of proposed rulemaking referred to the text of temporary rules, the Treasury decision includes the nonsubstantive, clerical changes needed to incorporate the temporary rule text into the final regulations.

The rules in these regulations address the nonpayment of tax on fuel that is entered into the United States. An enterer's failure to pay this tax not only gives it a competitive price advantage over its compliant competitors, but it also deprives the United States Treasury of revenue intended for the Highway Trust Fund. The final regulations do not impose a new tax burden on enterers of taxable fuel. Instead, the regulations simply provide the IRS with an additional enforcement tool to collect the tax that is owed under existing law and give an additional incentive for enterers to be registered.

The imposition of tax on the entry of fuel sold on reservations results not from these regulations but from the statute, which does not provide an exemption from the tax for fuel sold on reservations. The only effect of these regulations is to improve the ability of the IRS to apply the tax consistently and fairly with respect to all taxpayers subject to the tax, without regard to whether or not the fuel is ultimately sold on tribal reservations.

The Treasury Department and IRS determined that these regulations are not subject to Executive Order 13175 (65 FR 67249) which obligates an agency to consult with tribal officials when developing "policies that have tribal implications." This executive order defines "policies that have tribal implications," in part, as regulations that have substantial direct effects on one or more Indian tribes. The regulations do not have tribal implications, as specified in Executive Order 13175, because they do not significantly or uniquely affect the communities of Indian tribal governments, nor do they impose direct compliance costs on them. Any economic effect of the fuel tax on tribal economies is a consequence of the statutory imposition of the tax, not the manner in which the regulations operate to implement the statute. Thus, Executive Order 13175 does not apply to the final or temporary regulations.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact of the regulations on small business.

Drafting Information

The principal author of these regulations is Celia Gabrysh, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS, the Treasury Department, and the Bureau of Customs and Border Protection, Department of Homeland Security, participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 48 and 602 are amended as follows:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 48.4081–1 is amended as follows:

1. Paragraph (b) is amended by revising the definition of *Enterer*.

2. The first sentence of paragraph (f)(2) is revised.

The revisions read as follows:

§48.4081–1 Taxable fuel; definitions.

* * * * *

(b) * * *

Enterer generally means the importer of record (under customs law) with respect to the taxable fuel, except that—

(1) If the importer of record is a customs broker engaged by the owner of the taxable fuel, the person for whom the broker is acting is the enterer; and

(2) If there is no importer of record for taxable fuel entered into the United States, the owner of the taxable fuel at the time it is brought into the United States is the enterer.

* * * * *

(f) * * *

(2) In paragraph (b) of this section the definition of *aviation gasoline* and the third sentence in the definition of *terminal* are applicable after January 1, 1998, the definition of *kerosene*, *excluded liquid*, and *taxable fuel* are applicable after June 30, 1998, and the definition of *enterer* is applicable to entries of taxable fuel after September 27, 2004. * * *

§48.4081–1T [Removed]

Par. 3. Section 48.4081–1T is removed.

Par. 4. Section 48.4081–3 is amended by revising paragraphs (c)(2)(ii) through (iv), and (j) to read as follows:

§48.4081–3 Taxable fuel; taxable events other than removal at the terminal rack.

* * * * *

(c) * * *

(2) * * *

(ii) *Joint and several liability of the importer of record.* The importer of record with respect to the taxable fuel is jointly and severally liable with the enterer for the tax imposed under paragraph (c)(1) of this section if—

(A) The importer of record is not the enterer of the taxable fuel; and

(B) The enterer is not a taxable fuel registrant.

(iii) *Conditions for avoidance of liability.* The importer of record is not liable for the tax under paragraph (c)(2)(ii) of this section if, at the time of the entry, the importer of record—

(A) Has an unexpired notification certificate (as described in §48.4081–5) from the enterer; and

(B) Has no reason to believe that any information in the notification certificate is false.

(iv) *Customs bond.* The Customs bond posted with respect to the importation of the fuel will not be charged for the tax imposed on the entry of the fuel if the enterer is a taxable fuel registrant. A Customs bond will not be charged for the tax imposed on the entry of the fuel covered by the bond, if at the time of entry, the surety—

(A) Has an unexpired notification certificate (as described in §48.4081–5) from the enterer; and

(B) Has no reason to believe that any information in the notification certificate is false.

* * * * *

(j) *Effective/applicability date*: This section is applicable January 1, 1994, except that paragraphs (c)(2)(ii) through (iv) of this section are applicable to entries of taxable fuel after September 27, 2004.

§48.4081–3T [Removed]

Par. 5. Section 48.4081–3T is removed.

§48.4081–5 [Amended]

Par. 6. Section 48.4081–5 is amended by revising paragraph (a) to read as follows:

(a) *Overview.* This section sets forth requirements for the notification certificate under §§48.4081–2(c)(2)(ii), 48.4081–3(c)(2)(iii) and (iv), 48.4081–3(d)(2)(iii), 48.4081–3(e)(2)(iii), 48.4081–3(f)(2)(ii), and 48.4081–4(c) to notify another person of the taxable fuel registrant's registration status.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is amended by removing the entry for §48.4081–3T, and revising the entry for §48.4081–3 in the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
48.4081–3	1545–1270 1545–1418 1545–1897
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 16, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 26, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 27, 2007, 72 F.R. 41222)

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402–1: Authority to make credits or refunds.
(Also: Section 6411; 1.6411–3.)

Limitations on setoff under sections 6402 and 6411. This ruling holds that the Service may credit an overpayment against unassessed internal revenue tax liabilities that have been determined in a statutory notice of deficiency sent to the taxpayer. It further holds that under section 6411(b) of the Code, the Service may credit a decrease in tax resulting from a tentative carryback adjustment against unassessed liabilities determined in a statutory notice of deficiency. Rev. Rul. 54–378 clarified.

Rev. Rul. 2007–51

ISSUES

(1) Does section 6402(a) of the Code allow the Service to credit an overpayment against unassessed internal revenue tax liabilities determined in a notice of deficiency?

(2) Does section 6411(b) of the Code allow the Service to credit a decrease in tax resulting from a tentative carryback adjustment against unassessed internal revenue tax liabilities determined in a notice of deficiency?

SCOPE

This revenue ruling only applies to internal revenue tax liabilities that are subject to the deficiency procedures of Subchapter B of Chapter 63 of the Code. This revenue ruling does not address the question of the Service's crediting rights prior to issuing a notice of deficiency, in the context of a termination assessment under section 6851 or otherwise. This revenue ruling also does not address the Service's crediting rights when a taxpayer is in bankruptcy (or other insolvency) proceedings. See Rev. Rul. 2007–52 (this Bulletin) for the Service's crediting rights when a taxpayer is in bankruptcy.

FACTS

Situation 1. On March 15, 2005, a corporate taxpayer filed its income tax return for the tax year ending December 31, 2004, claiming a refund of $500,000. On April 15, 2005, the Service sent a notice of deficiency to the taxpayer for tax year 2003 in the amount of $1,000,000. As of April 15, 2005, the Service had not refunded the $500,000 overpayment for tax year 2004 or assessed the $1,000,000 deficiency for tax year 2003.

Situation 2. On March 15, 2005, a corporate taxpayer filed a Form 1139, *Corporation Application for Tentative Refund,* carrying back a net operating loss from tax year 2004 to tax year 2002. The carryback generated a $250,000 decrease in tax for tax year 2002. On April 15, 2005, the Service sent a notice of deficiency to the taxpayer for tax year 2003 in the amount of $1,000,000. As of April 15, 2005, the Service had not assessed the $1,000,000 deficiency for tax year 2003 or tentatively refunded the $250,000 decrease in tax for tax year 2002.

LAW

Authority to Make Credits or Refunds

Section 6402(a) provides that within the applicable period of limitations the Secretary may credit the amount of any overpayment, including interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment. The Secretary shall refund any balance to the person who made the overpayment, subject to further credit against amounts specified in sections 6402(c), (d), and (e). Regulations under section 6402(a) similarly provide that credit may be made against "any outstanding liability." *See* section 301.6402–1 of the Regulations on Procedure and Administration.

Tentative Carryback and Refund Adjustments

Section 6411(a) provides that a taxpayer may file an application for tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback, a business credit carryback, or a capital loss carryback from any taxable year. The application shall be made on Form 1139 or, in the case of taxpayers other than corporations, on Form 1045, and shall set forth in detail the information required by sections 6411(a)(1) through (a)(6) and by section 1.6411–1 of the Income Tax Regulations.

Section 6411(b) provides, in general, that within a period of 90 days from the date of filing the application for tentative carryback adjustment, the Secretary shall make a limited examination of the application to discover omissions and errors of computation, and shall determine the amount of the decrease in tax attributable to the carryback. *See also* section 1.6411–3(b) of the Income Tax Regulations.

Pursuant to section 6411(b) and section 1.6411–3(d), the decrease in tax attributable to the carryback shall, in the following order:

1. be applied under section 1.6411–3(d)(1) against any unpaid amount of the tax with respect to which such decrease was determined (*i.e.*, unpaid tax for the carryback year);
2. be credited under section 1.6411–3(d)(2) against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss carryback, business credit carryback, or capital loss carryback, the time for payment of which was extended under section 6164; and
3. be credited under section 1.6411–3(d)(3) against any tax or installment thereof "then due" from the taxpayer, and, if not so credited, be refunded to the taxpayer.

ANALYSIS

Authority to Make Credits

Section 6402 permits the Service to credit overpayments against "any liability in respect of an internal revenue tax on

the part of the person who made the overpayment." Neither section 6402 nor the associated regulations specify when "any liability" arises for purposes of determining when the Service may credit an overpayment. It is, however, well-established that the Internal Revenue Code imposes income tax liability based on an annual accounting period. *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 363 (1931) (tax liability is based on the net result of all transactions occurring during a fixed accounting period); *Edelson v. Commissioner*, 829 F.2d 828, 834 (9th Cir. 1987) ("[T]ax liabilities, though unassessed, are deemed obligations due and owing at the close of the taxable year."). Moreover, the accrual of an income tax liability is not dependent on the Service sending a notice of deficiency. Nor is the accrual of a tax liability dependent on the Service making an assessment. *Goldston v. United States*, 104 F.3d 1198, 1199–1200 (10th Cir. 1997) (tax liability arises from statutory duty to pay tax, not assessment of liability); *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985) (assessment is an administrative determination that is not a prerequisite to tax liability.)

For purposes of the crediting provisions of section 6402(a), an internal revenue tax liability for a tax year will arise no later than the date on which the Service sends a notice of deficiency to the taxpayer pursuant to section 6212 that identifies the nature and amount of the tax liability. Although there are circumstances in which an internal revenue tax liability may be a "liability in respect of an internal revenue tax" within the meaning of section 6402(a) prior to the issuance of a notice of deficiency they are outside the scope of this revenue ruling.

Section 6411(b) permits, after application to other unpaid amounts, the decrease in tax attributable to a carryback to be credited against "any tax . . . then due from the taxpayer." *See also* section 1.6411–3(d)(3) of the Income Tax Regulations. Neither section 6411(b) nor the regulations thereunder specify when a tax liability is "then due" for purposes of determining when the Service can credit a carryback adjustment. Case law analyzing the phrase "then due" in the context of predecessor statutes to section 6402, while consistent with this revenue ruling, does not aid in the interpretation of the phrase because these cases involve inconsistent treatment of overpayment and underpayment interest, and the statutory scheme relating to the accrual of interest has since changed. *See McCarl v. United States*, 42 F.2d 346 (D.C. Cir. 1930); *Standard Oil Co. v. United States*, 5 F. Supp. 976, 988 (Ct. Cl. 1934).

Section 6151(a) prescribes the time for when a payment of tax is due. The statute provides that a person required to file a return shall, without assessment or notice or demand from the Secretary, pay the tax at the time fixed for filing the return (determined without regard to extensions). It follows that, in the context of a deficiency, an internal revenue tax liability is "then due" for purposes of section 6411 no later than the date on which the Service issues a notice of deficiency to the taxpayer identifying a tax liability that is past due. Circumstances in which an internal revenue tax liability may, in the context of a deficiency, be "then due" within the meaning of section 6411(b) prior to issuance of a notice of deficiency are outside the scope of this revenue ruling.

Although sections 6402(a) and 6411(b) do not require a deficiency determination or assessment as a prerequisite to the Service crediting an overpayment or a carryback adjustment to a tax liability, the Service generally does not make such credits until the tax liability is determined with specificity. When the Service issues a notice of deficiency, it has determined the tax liability with specificity. Liabilities set forth in a notice of deficiency generally are presumed to be correct at the time the notice of deficiency is sent. *See Helvering v. Taylor*, 293 U.S. 507, 515 (1935) ("Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's [deficiency] determination is invalid."); *Merkel v. Commissioner*, 192 F.3d 844, 852 (9th Cir. 1999) ("Determinations made by the Commissioner in a notice of deficiency normally are presumed to be correct, and the taxpayer bears the burden of proving that those determinations are erroneous.").

Accordingly, section 6402(a) permits the Service to credit an overpayment against an unassessed tax liability if the Service has determined the amount of the tax liability in a notice of deficiency sent to the taxpayer pursuant to section 6212. Similarly, section 6411(b) permits the Service to credit a decrease in tax against an unassessed tax liability if, within the 90-day period, the Service has determined the amount of the tax liability in a notice of deficiency sent to the taxpayer pursuant to section 6212. *See* section 1.6411–3(d)(3) of the Income Tax Regulations.

Clarification of Prior Guidance

In Rev. Rul. 54–378, 1954–2 C.B. 246, the Service announced a policy of making partial allowances of refunds or credits under section 322(a)(1) of the 1939 Code, the predecessor to section 6402(a). In Rev. Rul. 54–378, the Service was required to credit any overpayment resulting from the allowance of partial overassessments against any income or excess profits tax assessed and then due from the taxpayer, and to refund the balance, if any, to the taxpayer. The facts in Rev. Rul. 54–378 focus on allowing partial refunds or credits when the Service and the taxpayer agree on the amount of an overassessment. Revenue Ruling 54–378 does not address the Service's right to credit an overpayment against a tax liability before the Service assesses the tax liability. This revenue ruling clarifies that Rev. Rul. 54–378 does not limit the Service to crediting overpayments only against assessed tax liabilities.

Crediting Rules Applied to Situations 1 and 2

Situation 1. The $1,000,000 tax liability determined in the notice of deficiency is an outstanding tax liability within the meaning of section 301.6402–1. Under section 6402(a), the Service may credit the $500,000 overpayment for tax year 2004 against the $1,000,000 tax liability identified in the notice of deficiency for tax year 2003.

Situation 2. The $1,000,000 tax liability determined in the notice of deficiency is an amount "then due" for purposes of section 6411(b). The Service may credit the $250,000 decrease in tax that was generated from the net operating loss carryback against the $1,000,000 tax liability for tax year 2003.

HOLDINGS

(1) Pursuant to section 6402(a), the Service may credit an overpayment against unassessed internal revenue tax liabilities

that have been determined in a notice of deficiency sent to the taxpayer.

(2) Pursuant to section 6411(b), the Service may credit a decrease in tax resulting from a tentative carryback adjustment against unassessed internal revenue tax liabilities determined in a notice of deficiency sent to the taxpayer.

EFFECT ON OTHER REVENUE RULINGS

Revenue Ruling 54–378 is clarified. Pursuant to section 6402(a), the Service is authorized to credit an overpayment not only against amounts of tax that are assessed, but also against outstanding tax liabilities such as those identified in a notice of deficiency sent to the taxpayer.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Joseph P. Dewald, formerly of the Office of the Associate Chief Counsel (Procedure and Administration), and Cynthia A. McGreevy of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue ruling, contact Cynthia A. McGreevy at (202) 622–4910 (not a toll-free call).

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26 CFR 301.6402–1: Authority to make credits or refunds.
(Also: Section 6411; 1.6411–3.)

Definition of a liability under section 6402(a) and 6411(b). This ruling holds that the Service has the right under section 6402 of the Code to credit an overpayment against internal revenue liabilities for which no assessment has been made, or statutory notice of deficiency issued, when the liabilities are identified in a proof of claim filing in a bankruptcy case. Similarly, the ruling holds that the Service has the right under section 6411(b) to credit a decrease in tax resulting from a tentative carryback adjustment against internal revenue tax liabilities for which no assessment has been made, or statutory notice of deficiency issued, when the liabilities are identified in a proof of claim filed in a bankruptcy case.

Rev. Rul. 2007–52

ISSUES

(1) Pursuant to section 6402(a) of the Internal Revenue Code (Code), may the Service credit an overpayment against outstanding internal revenue tax liabilities for which no assessment has been made or notice of deficiency sent when the liabilities are identified in a proof of claim filed in a bankruptcy case?

(2) Pursuant to section 6411(b) of the Code, may the Service credit a decrease in tax resulting from a tentative carryback adjustment against internal revenue tax liabilities for which no assessment has been made or notice of deficiency sent when the liabilities are identified in a proof of claim filed in a bankruptcy case?

SCOPE

This revenue ruling addresses the making of credits for periods ending before the commencement of a bankruptcy case against liabilities for periods also arising before the commencement of the case. This ruling does not address bankruptcy issues that could affect the timing or allowance of the Service's right to credit overpayments and decreases in tax against other liabilities, such as the bankruptcy automatic stay. *See* 11 U.S.C. § 362. See Rev. Rul. 2007–51 (this Bulletin) for the making of credits when a taxpayer is not in bankruptcy.

FACTS

Situation 1. On February 1, 2005, a corporate taxpayer filed a petition for relief under Chapter 11 of the Bankruptcy Code (11 U.S.C. § 101 *et seq.*). The taxpayer filed a corporate income tax return for the year ending December 31, 2004 on March 15, 2005, reporting an overpayment and claiming a refund of $500,000. On April 15, 2005, the Service filed a proof of claim in the bankruptcy case identifying liabilities for the taxpayer's 2003 tax year in the amount of $1,000,000. As of April 15, 2005, the Service had not refunded the $500,000 overpayment, assessed the $1,000,000 liability, or sent a notice of deficiency with respect to that liability.

Situation 2. On February 1, 2005, a corporate taxpayer filed a petition for relief under Chapter 11 of the Bankruptcy Code. The taxpayer filed a corporate income tax return for the year ending December 31, 2004 on March 15, 2005, reporting a $750,000 net operating loss. Also on March 15, 2005, the taxpayer filed an application for a tentative carryback adjustment, carrying the $750,000 net operating loss from 2004 back to 2003, generating a decrease in tax for the 2003 tax year in the amount of $250,000, and requesting a refund. On April 15, 2005, the Service filed a proof of claim in the bankruptcy case identifying liabilities for the taxpayer's 2002 tax year in the amount of $1,000,000. As of April 15, 2005, the Service had not assessed the $1,000,000 liability, sent a notice of deficiency with respect to that liability, or tentatively refunded the $250,000 decrease in tax for the 2002 year.

LAW

Authority to Make Credits or Refunds

Section 6402(a) of the Code provides that within the applicable period of limitations the Secretary may credit the amount of any overpayment, including interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment. The Secretary shall refund any balance to the person who made the overpayment, subject to further credit against amounts specified in sections 6402(c), (d), and (e). Regulations under section 6402(a) similarly provide that credit may be made against "any outstanding liability." *See* section 301.6402–1 of the Regulations on Procedure and Administration.

Tentative Carryback and Refund Adjustments

Section 6411(a) of the Code provides that a taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback, a business credit carryback, or a capital loss carryback from any taxable year. The application shall be made on Form 1139 or, in the case of taxpayers other than corporations, on Form 1045, and shall set forth in detail the information required by sections 6411(a)(1) through (a)(6) and by section 1.6411–1 of the Income Tax Regulations.

Section 6411(b) of the Code provides, in general, that within a period of 90 days from the date of filing the application for tentative carryback adjustment, the Secretary shall make a limited examination of the application to discover omissions and errors of computation, and shall determine the amount of the decrease in the tax attributable to the carryback. *See also* section 1.6411–3(b) of the Income Tax Regulations.

Pursuant to section 6411(b) and section 1.6411–3(d) of the Income Tax Regulations, the decrease in tax attributable to the carryback shall, in the following order:

1. be applied under section 1.6411–3(d)(1) against any unpaid amount of the tax with respect to which such decrease was determined (*i.e.*, unpaid tax for the carryback year);
2. be credited under section 1.6411–3(d)(2) against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss carryback, business credit carryback, or capital loss carryback, the time for payment of which was extended under section 6164; and
3. be credited against any tax or installment thereof "then due" from the taxpayer and, if not so credited, be refunded to the taxpayer.

Tax Claims in Bankruptcy

In a bankruptcy case, a properly filed proof of claim identifying a tax liability constitutes *prima facie* evidence of the existence and amount of that liability. Bankruptcy Rule 3001(f); *Bronson v. United States*, 46 F.3d 1573, 1581 (Fed. Cir. 1995). The filing of a proof of claim by the Service, like all routine government actions, is entitled to a presumption of regularity. *See United States v. Chemical Foundation, Inc.*, 272 U.S. 1, 14–15 (1926). *See also United States v. Mangan*, 575 F.2d 32, 41 (2nd Cir. 1978); *United States v. Ahrens*, 530 F.2d 781, 785–86 (8th Cir. 1976). Bankruptcy courts have jurisdiction to determine the amount or legality of tax identified on a proof of claim. *See* 11 U.S.C. §§ 502, 505.

ANALYSIS

Section 6402 of the Code permits the Service to credit a tax overpayment against "any liability in respect of an internal revenue tax on the part of the person who made the overpayment." Neither section 6402 nor the associated regulations specify when "any liability" arises for purposes of determining when the Service may credit an overpayment. It is, however, well-established that the Internal Revenue Code imposes income tax liability based on an annual accounting period. *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359, 363 (1931) (tax liability is based on the net result of all transactions occurring during a fixed accounting period); *Edelson v. Commissioner*, 829 F.2d 828, 834 (9th Cir. 1987) ("[T]ax liabilities, though unassessed, are deemed obligations due and owing at the close of the taxable year."). Moreover, the accrual of an income tax liability is not dependent on the Service sending a notice of deficiency. Nor is the accrual of a tax liability dependent on the Service making an assessment. *Goldston v. United States*, 104 F.3d 1198, 1199–1200 (10th Cir. 1997) (tax liability arises from statutory duty to pay tax, not assessment of liability); *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985) (assessment is an administrative determination that is not a prerequisite to tax liability.)

Section 6411(b) of the Code provides an ordering rule for allowance of carryback adjustments that authorizes the crediting of a decrease in tax resulting from a tentative carryback adjustment against "any tax or installment thereof then due from the taxpayer." Section 6411(b) does not, by its terms, limit the Service to crediting only against tax liabilities for which an assessment has been made or notice of deficiency sent. Rather, the right to credit arises when the liability is "then due." Section 6151(a) of the Code prescribes the time when a payment of tax is generally due. The statute provides that a person required to file a return shall, without assessment or notice or demand from the Secretary, pay the tax at the time fixed for filing the return (determined without regard to extensions).

Although sections 6402(a) and 6411(b) do not require a deficiency determination or assessment as a prerequisite to the Service crediting an overpayment or a carryback adjustment to a tax liability, the Service generally does not make such credits until the tax liability is determined with specificity. Outside the bankruptcy context, the Service will generally make a credit only after issuance of a notice of deficiency. *See* Rev. Rul. 2007–51. When the Service issues a notice of deficiency, it has determined tax liability with specificity. Liabilities set forth in a notice of deficiency are generally presumed to be correct at the time the notice of deficiency is sent. *See Helvering v. Taylor*, 293 U.S. 507, 515 (1935); *Merkel v. Commissioner*, 192 F.3d 844, 852 (9th Cir. 1999).

When the taxpayer is a debtor in bankruptcy, the same considerations do not compel the Service to limit crediting against liabilities to situations where a notice of deficiency has been sent. A proof of claim filed by the Service in the bankruptcy case represents a specific administrative determination of the nature and amount of the tax debt. A proof of claim is *prima facie* evidence of the validity and amount of the claim and is entitled to a presumption of regularity. *See* Bankruptcy Rule 3001(f); *Chemical Foundation*, 272 U.S. at 14–15. Further, a debtor in a bankruptcy case has a ready forum for the judicial determination of the tax debt since bankruptcy courts have authority to determine tax liabilities identified on a proof of claim. *See* 11 U.S.C. §§ 502, 505. Therefore, in the bankruptcy context, the Service has the authority to make credits under section 6402(a) and section 6411(b) against income tax liabilities where such liabilities are identified on a proof of claim filed in a bankruptcy case.

CREDITING RULES APPLIED TO SITUATIONS 1 AND 2

Situation 1. The $1,000,000 liability identified on the proof of claim is an outstanding liability for purposes of section 6402(a). Under section 6402(a), the Service may credit the $500,000 overpayment for tax year 2004 against the $1,000,000 tax liability identified on the proof of claim for tax year 2003.

Situation 2. The $1,000,000 liability identified on the proof of claim is an amount "then due" for purposes of section 6411(b). Under section 6411(b), the Service may credit the $250,000 decrease

in tax generated from the net operating loss carryback against the tax liability for 2002.

HOLDINGS

(1) Pursuant to section 6402(a), the Service may credit an overpayment against unassessed internal revenue tax liabilities that have not been identified in a notice of deficiency sent to the taxpayer when the liabilities are identified in a proof of claim filed in a bankruptcy case.

(2) Pursuant to section 6411(b), the Service may credit a decrease in tax resulting from a tentative carryback adjustment against unassessed internal revenue tax liabilities that have not been identified in a notice of deficiency sent to the taxpayer when the liabilities are identified in a proof of claim filed in a bankruptcy case.

DRAFTING INFORMATION

The principal author of this revenue ruling is G. William Beard of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue ruling, contact Mr. Beard at 202–622–3620 (not a toll-free call).

Section 6411.—Tentative Carryback and Refund Adjustments

26 CFR 1.6411–2T: Computation of tentative carryback adjustment.
(Also: Section 6402; 1.6411–3T.)

Revocation of Rev. Rul.; tentative allowance. The IRS has determined that Rev. Rul. 78–369 is inconsistent with the regulations under section 6411 of the Code. Rev. Rul. 78–369 revoked.

Rev. Rul. 2007–53

TEXT

The Internal Revenue Service has determined that Rev. Rul. 78–369 is inconsistent with the regulations under section 6411 of the Internal Revenue Code. Temporary, final, and proposed regulations published in this issue of the Internal Revenue Bulletin clarify that the computation and allowance of a tentative refund under section 6411 is a two-step process. Rev. Rul. 78–369, 1978–2 C.B. 324, is revoked.

The decrease in tax previously determined (tentative allowance) is computed pursuant to Treas. Reg. § 1.6411–2 but applied pursuant to Treas. Reg. § 1.6411–3. For purposes of computing the allowance, the Commissioner will not consider amounts to which the taxpayer and the Commissioner are in disagreement. For purposes of applying the allowance, however, the Commissioner may credit or reduce the tentative adjustment by any assessed tax liabilities, unassessed liabilities determined in a statutory notice of deficiency, unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, and other unassessed liabilities in rare and unusual circumstances. *See* Temp. Treas. Reg. §§ 1.6411–2T and 1.6411–3T; Rev. Rul. 2007–51 and Rev. Rul. 2007–52 (this Bulletin).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78–369, 1978–2 C.B. 324, is revoked.

DRAFTING INFORMATION

The principal author of this revenue ruling is Cynthia Ann McGreevy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Cynthia Ann McGreevy at 202–622–4910 (not a toll-free call).

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26 CFR 1.6411–2: Computation of tentative carryback adjustment.

T.D. 9355

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Clarification of Section 6411 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations clarifying that for purposes of allowing a tentative adjustment, the IRS may credit or reduce the tentative adjustment by an assessed tax liability, whether or not that tax liability was assessed before the date the application for tentative carryback was filed, and other unassessed tax liabilities in certain other circumstances. The portions of this document that are final regulations provide technical revisions that remove all references to IRS district director and service center director, as those positions no longer exist within the IRS. The offices of the district director and service center director were eliminated by the IRS reorganization implemented pursuant to the IRS Reform and Restructuring Act of 1998. The text of the temporary regulations serves as the text of the proposed regulations (REG–118886–06), set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective August 27, 2007.

Applicability Date: These regulations apply with respect to applications for tentative refund filed on or after August 27, 2007.

FOR FURTHER INFORMATION CONTACT: Cynthia A. McGreevy, (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

These regulations clarify the Income Tax Regulations (26 CFR part 1) under section 6411 relating to the computation and allowance of the tentative carryback adjustment. The tentative allowance is computed pursuant to §1.6411–2 but applied pursuant to §1.6411–3. These temporary regulations clarify that, for purposes of computing the allowance, the Commissioner will not consider amounts to which the taxpayer and the Commissioner are in disagreement. For purposes of applying the allowance, however, the Commissioner may credit or reduce the tentative adjustment by any assessed tax liabilities, unassessed liabilities determined in a statutory notice of deficiency,

unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, and other unassessed liabilities in rare and unusual circumstances. Regarding unassessed liabilities determined in a statutory notice of deficiency, see Rev. Rul. 2007–51 (this Bulletin). Regarding unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, see Rev. Rul. 2007–52 (this Bulletin). See §601.601(d)(2). The IRS plans to adopt procedures requiring IRS National Office review prior to a credit or reduction of the tentative adjustment by an unassessed liability that constitutes a rare and unusual circumstance.

These regulations also contain final regulations that remove all references to IRS district director or service center director, to account for the IRS's current organizational structure. The text of the temporary regulations serves as the text of the proposed regulations, published elsewhere in this issue of the Bulletin.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) please refer to the Special Analyses section of the preamble of the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these final and temporary regulations is Cynthia A. McGreevy of the Office of the Associate Chief Counsel (Procedure and Administration).

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.6411–2 [Amended]

Par. 2. In the list below, for each section listed in the left column, remove the language in the middle column and add the language in the right column:

Section	*Remove*	*Add*
1.6411–2(a), first sentence	, unused investment credit, or unused WIN credit	, or unused investment credit
1.6411–2(a), fourth sentence	Internal Revenue Service	Commissioner
1.6411–2(a), last sentence	32	33
1.6411–2(b), third sentence	Internal Revenue Service	Commissioner
1.6411–2(b), fourth sentence	district director	Commissioner
1.6411–2(b), fourth sentence	Internal Revenue Service	Commissioner

Par. 3. Section 1.6411–2(c) is added to read as follows:

§1.6411–2 Computation of tentative carryback adjustment.

* * * * *

(c) *Effective/applicability date*. These regulations apply with respect to applications for tentative refund filed on or after August 27, 2007.

Par. 4. Section 1.6411–2T is added to read as follows:

§1.6411–2T Computation of tentative carryback adjustment (temporary).

(a) *Tax previously determined*. The taxpayer is to determine the amount of decrease, attributable to the carryback, in tax previously determined for each taxable year before the taxable year of the net operating loss, net capital loss, or unused investment credit. The tax previously determined is to be ascertained in accordance with the method prescribed in section 1314(a). Thus, the tax previously determined will be the tax shown on the return as filed, increased by any amounts assessed (or collected without assessment) as deficiencies before the date of the filing of the application for a tentative carryback adjustment, and decreased by any amounts abated, credited, refunded, or otherwise repaid prior to that date. Any items as to which the Commissioner and the taxpayer are in disagreement at the time of the filing of the application shall, for purposes of §1.6411–2, be taken into account in ascertaining the tax previously determined only if, and to the extent that, they were reported in the return, or were reflected in any amounts assessed (or collected without assessment) as deficiencies, or in any amounts abated, credited, refunded, or otherwise repaid, before the date of filing the application. The tax previously determined, therefore, will reflect the foreign

tax credit and the credit for tax withheld at source provided in section 33.

(b) *Decrease attributable to carryback.* After ascertaining the tax previously determined in the manner described in paragraph (a) of this section, the taxpayer shall determine the decrease in tax previously determined attributable to the carryback and any related adjustments on the basis of the items of tax taken into account in computing the tax previously determined. In determining any decrease attributable to the carryback or any related adjustment, items shall be taken into account under this subsection only to the extent that they were reported in the return, or were reflected in amounts assessed (or collected without assessment) as deficiencies, or in amounts abated, credited, refunded, or otherwise repaid, before the date of filing the application for a tentative carryback adjustment. If the Commissioner and the taxpayer are in disagreement as to the proper treatment of any item, it shall be assumed for purposes of determining the decrease in the tax previously determined that the item was correctly reported by the taxpayer unless, and to the extent that, the disagreement has resulted in the assessment of a deficiency (or the collection of an amount without an assessment), or the allowing or making of an abatement, credit, refund, or other repayment, before the date of filing the application. Thus, if the taxpayer claimed a deduction on its return of $50,000 for salaries paid its officers but the Commissioner proposes that the deduction should not exceed $20,000, and the Commissioner and the taxpayer have not agreed on the amount properly deductible before the date the application for a tentative carryback adjustment is filed, $50,000 shall be considered as the amount properly deductible for purposes of determining the decrease in tax previously determined in respect of the application for a tentative carryback adjustment. In determining the decrease in tax previously determined, any items which are affected by the carryback must be adjusted to reflect the carryback. Thus, unless otherwise provided, any deduction limited, for example, by adjusted gross income, such as the deduction for medical, dental, etc., expenses, is to be recomputed on the basis of the adjusted gross income as affected by the carryback. See §1.6411–3T(d) for rules on the application of the decrease in tax to any tax liability.

(c) *Effective/applicability date.* (1) These regulations apply with respect to applications for tentative refund filed on or after August 27, 2007. (2) The applicability of this section expires on or before August 24, 2010.

Par. 5. **§1.6411–3 [Amended].** In the list below, for each section listed in the left column, remove the language in the middle column and add the language in the right column:

Section	*Remove*	*Add*
1.6411–3(a), first sentence	district director or director of a service center (either of whom are sometimes hereinafter referred to in this section as internal revenue officer)	Commissioner
1.6411–3(a)(2), first sentence	, unused investment credit, or unused WIN credit	, or unused investment credit
1.6411–3(b), first sentence	district director or director of a service center	Commissioner
1.6411–3(b), first sentence	he deems	deemed
1.6411–3(b), second sentence	He	The Commissioner
1.6411–3(b), fourth sentence	Such internal revenue officer	The Commissioner
1.6411–3(b), fourth sentence	he may discover	discovered
1.6411–3(b), fifth sentence	he accordingly	the Commissioner accordingly
1.6411–3(b), fifth sentence	he may	may
1.6411–3(b), fifth sentence	, unused investment credit, or unused WIN credit	, or unused investment credit
1.6411–3(b), fifth sentence	, investment credit or WIN credit	, or investment credit
1.6411–3(b), sixth sentence	such internal revenue officer	the Commissioner

Section	Remove	Add
1.6411–3(b), sixth sentence	he	the Commissioner
1.6411–3(b), sixth sentence	his	the Commissioner's
1.6411–3(b), seventh sentence	such internal revenue officer	the Commissioner
1.6411–3(b), seventh sentence	he believes	the Commissioner believes
1.6411–3(b), seventh sentence	he will	the Commissioner will
1.6411–3(b), seventh sentence	such officer	the Commissioner
1.6411–3(c), first sentence	district director or director of a service center	Commissioner
1.6411–3(c), first sentence	he	the Commissioner
1.6411–3(c), second sentence	he deems	the Commissioner deems
1.6411–3(c), second sentence	by him	
1.6411–3(c), second sentence	he	the Commissioner
1.6411–3(c), third sentence	Such internal revenue officer's	The Commissioner's
1.6411–3(c), third sentence	he	the Commissioner
1.6411–3(c), fourth sentence	his	the Commissioner's
1.6411–3(c), fifth sentence	such internal revenue officer	the Commissioner
1.6411–3(d)(1), first sentence	district director or director of a service center	Commissioner
1.6411–3(d)(1)(iii), first sentence	including an amount the time for payment of which has been extended under section 6162, but	
1.6411–3(d)(2), first sentence	district director, or director of a service center	Commissioner
1.6411–3(d)(2), fifth sentence	such internal revenue officer	the Commissioner
1.6411–3(d)(2), fifth sentence	, unused investment credit, or unused WIN credit	, or unused investment credit
1.6411–3(d)(3), first sentence	district director or director of a service center	Commissioner

Par. 6. Section 1.6411–3(e) is added to read as follows:

§1.6411–3 Allowance of adjustments.

* * * * *

(e) *Effective/applicability date.* These regulations apply with respect to applications for tentative refund filed on or after August 27, 2007.

Par. 7. Section 1.6411–3T is added to read as follows:

§1.6411–3T Allowance of adjustments (temporary).

(a) *Time prescribed.* The Commissioner shall act upon any application for a tentative carryback adjustment filed under section 6411(a) within a period of 90 days from whichever of the following two dates is the later—

(1) The date the application is filed; or

(2) The last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss, net capital loss, or unused investment credit from which the carryback results.

(b) *Examination*. Within the 90-day period described in paragraph (a) of this section, the Commissioner shall make, to the extent deemed practicable within this period, an examination of the application to discover omissions and errors of computation. The Commissioner shall determine within this period the decrease in tax previously determined, affected by the carryback or any related adjustments, upon the basis of the application and examination. The decrease shall be determined in the same manner as that provided in section 1314(a) for the determination by the taxpayer of the decrease in taxes previously determined which must be set forth in the application for a tentative carryback adjustment. The Commissioner, however, may correct any errors of computation or omissions discovered upon examination of the application. In determining the decrease in tax previously determined which is affected by the carryback or any related adjustment, the Commissioner may correct any mathematical error appearing on the application and may likewise correct any modification required by the law and incorrectly made by the taxpayer in computing the net operating loss, net capital loss, or unused investment credit, the resulting carrybacks, or the net operating loss deduction, capital loss deduction, or investment credit allowable. If the required modification has not been made by the taxpayer and the Commissioner has the necessary information to make the modification within the 90-day period, the Commissioner may, in the Commissioner's discretion, make the modification. In determining the decrease, however, the Commissioner will not, for example, change the amount claimed on the return as a deduction for depreciation because the Commissioner believes that the taxpayer has claimed an excessive amount; likewise, the Commissioner will not include in gross income any amount not so included by the taxpayer, even though the Commissioner believes that the amount is subject to tax and properly should be included in gross income.

(c) *Disallowance in whole or in part*. If the Commissioner finds that an application for a tentative carryback adjustment contains material omissions or errors of computation, the Commissioner may disallow such application in whole or in part without further action. If, however, the Commissioner deems that any error of computation can be corrected within the 90-day period, the Commissioner may do so and allow the application in whole or in part. The Commissioner's determination as to whether the Commissioner can correct any error of computation within the 90-day period shall be conclusive. Similarly, the Commissioner's action in disallowing, in whole or in part, any application for a tentative carryback adjustment shall be final and may not be challenged in any proceeding. The taxpayer may, however, file a claim for credit or refund under section 6402, and may maintain a suit based on the claim if it is disallowed or if the Commissioner does not act upon the claim within 6 months from the date it is filed.

(d) *Application of decrease*. (1) Each decrease determined by the Commissioner in any previously determined tax which is affected by the carryback or any related adjustments shall first be applied against any unpaid amount of the tax with respect to which such decrease was determined. The unpaid amount of tax may include one or more of the following:

(i) An amount with respect to which the taxpayer is delinquent.

(ii) An amount the time for payment of which has been extended under section 6164 and which is due and payable on or after the date of the allowance of the decrease.

(iii) An amount (not including an amount the time for payment of which has been extended under section 6164) which is due and payable on or after the date of the allowance of the decrease, including any assessed liabilities, unassessed liabilities determined in a statutory notice of deficiency, unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, and other unassessed liabilities in rare and unusual circumstances.

(2) If the unpaid amount of tax includes more than one unpaid amount, the Commissioner in his discretion, shall determine against which amount or amounts, and in what proportion, the decrease is to be applied. In general, however, the decrease will be applied against any amounts described in paragraphs (d)(1)(i) through (iii) of this section in the order named. If there are several amounts of the type described in paragraph (d)(1)(iii) of this section, any amount of the decrease which is to be applied against the amount will be applied by assuming that the tax previously determined minus the amount of the decrease to be so applied is "the tax" and that the taxpayer had elected to pay the tax in installments. The unpaid amount of tax against which a decrease may be applied under paragraph (d)(1) of this section may not include any amount of tax for any taxable year other than the year of the decrease. After making the application, the Commissioner will credit any remainder of the decrease against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss, capital loss, or unused investment credit, the time for payment of which has been extended under section 6164.

(3) Any remainder of the decrease after the application and credits may, within the 90-day period, in the discretion of the Commissioner, be credited against any tax liability or installment thereof then due from the taxpayer (including assessed liabilities, unassessed liabilities determined in a statutory notice of deficiency, unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, and other unassessed liabilities in rare and unusual circumstances), and, if not so credited, shall be refunded to the taxpayer within the 90-day period.

(e) *Effective/applicability date*.

(1) These regulations apply with respect to applications for tentative refund filed on or after August 27, 2007.

(2) The applicability of this section expires on or before August 24, 2010.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 1, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 27, 2007, 72 F.R. 48933)

Section 7508.—Time for Performing Certain Acts Postponed by Reason of Service in Combat Zone or Contingency Operation

(Also Sections 6081, 7508A; 11 U.S.C. §§ 507, 523, 727.)

Bankruptcy effects of disaster and combat zone relief. This ruling provides that the postponement of the time to file a return under section 7508 or 7508A of the Code does not change the date that the return is last due, including extensions, and therefore does not change the priority and dischargeability of the tax for bankruptcy purposes.

Rev. Rul. 2007–59

ISSUES

(1) Does a grant of relief by the Internal Revenue Service under section 7508A of the Internal Revenue Code, which postpones the time in which a taxpayer affected by a Presidentially-declared disaster may timely file an income tax return, change the date on which the return is "last due, including extensions" under section 507(a)(8)(A)(i) of Title 11 of the United States Code (Bankruptcy Code), and thereby affect the priority and dischargeability of the related tax liability in bankruptcy?

(2) Does relief under section 7508 of the Code, which postpones the time in which an individual taxpayer may timely file an income tax return, change the date on which the return is "last due, including extensions" under section 507(a)(8)(A)(i) of the Bankruptcy Code or "last due, under applicable law or under any extension" under section 523(a)(1)(B)(ii) of the Bankruptcy Code, and thereby affect the priority and dischargeability of the related tax liability in bankruptcy?

FACTS

Situation 1. *A* is an individual who uses the cash receipts and disbursements method of accounting and files federal income tax returns on a calendar year basis. On April 12, 2007, *A* timely requests a 6-month extension of time to file an income tax return for 2006. *A*'s principal residence for purposes of section 1033(h)(4) of the Code is in County X in State Y. On October 2, 2007, disaster *Q* strikes State Y. On October 5, 2007, the President declares a disaster within the meaning of section 1033(h)(3). The Service determines that County X is in a covered disaster area within the meaning of section 301.7508A–1(d)(2) of the Procedure and Administration Regulations for purposes of disaster *Q*. The Service issues a news release announcing relief for taxpayers affected by disaster *Q*. The news release defines the period from October 2, 2007, through December 31, 2007, as a disaster relief period and provides that the deadlines for specified acts, including the filing of an income tax return, that fall within the disaster relief period are postponed until December 31, 2007. *A* files an income tax return for 2006 showing a balance due on December 20, 2007. *A* files a Chapter 7 bankruptcy petition on November 24, 2010, listing the Service as a creditor with respect to the 2006 income tax liability. The case is treated as a "no-asset" Chapter 7 case, and the Service does not file a proof of claim with respect to *A*'s 2006 federal income tax liability. *See* Fed. R. Bankr. Proc. 2002(e). On January 18, 2011, the bankruptcy court grants *A* a discharge pursuant to section 727(a) of the Bankruptcy Code.

Situation 2. *B* is an individual who uses the cash receipts and disbursements method of accounting and files federal income tax returns on a calendar year basis. *B* serves in the United States Armed Forces in an area designated by the President of the United States by Executive Order as a combat zone for purposes of section 112 of the Code from March 17, 2005, through August 1, 2006. On September 20, 2006, *B* files an income tax return for 2004 showing a balance due. *B* files a Chapter 7 bankruptcy petition on November 3, 2008, listing the Service as a creditor with respect to the 2004 federal income tax liability. The case is treated as a "no-asset" Chapter 7 case, and the Service does not file a proof of claim. *See* Fed. R. Bankr. Proc. 2002(e). On December 11, 2008, the bankruptcy court grants *B* a discharge pursuant to section 727(a) of the Bankruptcy Code.

Situation 3. Same facts as *Situation 2*, except that *B* files a Chapter 7 bankruptcy petition on September 1, 2008, instead of November 3, 2008.

LAW AND ANALYSIS

Section 6072(a) of the Code provides that calendar year income tax returns for individuals are due on or before the 15th day of April following the close of the calendar year.

Section 6081(a) provides that the Secretary may grant a reasonable extension of time (generally not to exceed six months) for filing any return, declaration, statement, or other document required by the Code or by regulations. An individual who files an application for an extension of time to file an income tax return under section 1.6081–4T(b) of the temporary Income Tax Regulations between December 31, 2005, and November 4, 2008, will be allowed an automatic 6-month extension of time to file the return. Section 1.6081–4T(a) and (f) of the temporary Income Tax Regulations.

Section 7508A(a)(1) provides for the disregard of a period of time of up to one year in determining the timeliness of specified acts performed by taxpayers who are determined by the Service to be affected by a Presidentially-declared disaster or a terroristic or military action. Section 7508A relief is not automatic, but requires a grant of relief by the Service, which is generally in the form of a news release or a notice published in the Internal Revenue Bulletin. The specified acts include the acts described in section 7508(a), such as the filing of income tax returns.

Section 7508(a)(1) provides for the disregard of a period of time in determining the timeliness of specified acts performed by individuals serving in the United States Armed Forces, or serving in support of the Armed Forces, in an area designated by the President as a combat zone pursuant to section 112 or serving with respect to a contingency operation (as defined in 10 U.S.C. § 101(a)(3)). Unlike section 7508A relief, the relief is automatic and not dependent on a grant of relief by the Service. Generally, the relief extends throughout the individual's period of service in the designated area or operation, plus any period of continuous qualified hospitalization attributable to an injury received while serving in the designated area or operation, plus the next 180 days. The specified acts include the filing of income tax returns. *See* section 7508(a)(1)(A).

An individual debtor in a Chapter 7 case may be granted a discharge. 11 U.S.C. § 727(a). A section 727(a) discharge covers all debts that arose before the bankruptcy case was filed, except those debts listed in section 523 of the Bankruptcy Code. 11 U.S.C. § 727(b). Pursuant to section 523(a)(1)(A) of the Bankruptcy Code, tax debts that are afforded eighth priority are excepted from discharge. Section 507(a)(8)(A)(i) of the Bankruptcy Code provides eighth priority for allowed unsecured pre-petition income tax claims for which a return is "last due, including extensions" after three years before the date of the filing of a bankruptcy petition.

Certain non-priority tax debts are also excepted from discharge under section 523(a)(1)(B) of the Bankruptcy Code. Section 523(a)(1)(B)(ii) of the Bankruptcy Code excepts from discharge any debt for a tax with respect to which a return was filed after the date on which it was "last due, under applicable law or any extension" and after two years before the date of the filing of a bankruptcy petition.

Situation 1. The due date for *A*'s 2006 income tax return is April 15, 2007. *See* section 6072. Because *A* timely requests an extension of time to file a 2006 income tax return, the date on which *A*'s 2006 return is due, including extensions, is October 15, 2007. *See* section 1.6081–4T of the temporary Income Tax Regulations.

A is an "affected taxpayer" as defined by section 301.7508A–1(d)(1)(i) of the Procedure and Administration Regulations with respect to disaster *Q*. Because the extended due date for *A*'s 2006 income tax return (October 15, 2007) falls within the disaster relief period granted in the news release, *A* may timely file a 2006 income tax return on or before December 31, 2007, the last day of the relief period.

Section 7508A relief does not change or extend the extended due date for filing *A*'s 2006 income tax return (October 15, 2007), which is fixed by sections 6072 and 6081(a) of the Code. Instead, section 7508A of the Code disregards the period of postponement and makes timely the filing of the 2006 return at any time during this period. Because section 7508A relief neither changes nor extends the extended due date, the postponement does not change the date on which the 2006 return is "last due, including extensions" under section 507(a)(8)(A)(i) of the Bankruptcy Code. Therefore, the date on which *A*'s 2006 income tax return is last due, including *A*'s automatic 6-month extension, remains October 15, 2007, rather than the last day of the relief period, December 31, 2007. In the Chapter 7 bankruptcy proceeding, a claim for *A*'s 2006 income tax liability would not be entitled to eighth priority under section 507(a)(8)(A)(i) of the Bankruptcy Code because the date on which *A*'s 2006 income tax return is last due, including extensions, is October 15, 2007, which precedes November 24, 2007, the date that is three years before the filing of the bankruptcy petition. Accordingly, *A*'s 2006 income tax liability is not excepted from discharge under section 523(a)(1)(A) of the Bankruptcy Code.

Situation 2. The due date for *B*'s 2004 income tax return is April 15, 2005. *See* section 6072. Because *B* is an individual serving in the United States Armed Forces in an area designated by the President of the United States by Executive Order as a combat zone from March 17, 2005, through August 1, 2006, the time within which *B* may timely file a 2004 income tax return is postponed for the period of service in the Armed Forces plus 180 days. Section 7508. The postponement also includes any unexpired portion of the time prescribed for filing a return that existed when *B* entered the combat zone. *See* Rev. Rul. 76–425, 1976–2 C.B. 447. *B* would thus have until February 26, 2007, to timely file a 2004 income tax return.

Section 7508 relief does not change or extend the due date for filing *B*'s 2004 income tax return, which is fixed by section 6072. Instead, section 7508 of the Code disregards the period of postponement and makes timely the filing of the 2004 return at any time during this period. Because section 7508 relief neither changes nor extends the due date, the postponement does not change the date on which the 2004 return is "last due, including extensions" under section 507(a)(8)(A)(i) of the Bankruptcy Code. Therefore, the date on which *B*'s 2004 income tax return is "last due, including extensions" remains April 15, 2005, rather than the last day of the relief period, February 26, 2007. In the Chapter 7 bankruptcy proceeding, a claim for *B*'s 2004 income tax liability would not be entitled to eighth priority under section 507(a)(8)(A)(i) because the date on which *B*'s 2004 income tax return is last due, including extensions, is April 15, 2005, which precedes November 3, 2005, the date that is three years before the filing of the bankruptcy petition. Accordingly, *B*'s 2004 income tax liability is not excepted from discharge under section 523(a)(1)(A) of the Bankruptcy Code.

Situation 3. As with Situation 2, the date on which *B*'s 2004 income tax return is "last due, including extensions" remains April 15, 2005, rather than the last day of the relief period, February 26, 2007. In the Chapter 7 bankruptcy proceeding, a claim for *B*'s 2004 income tax liability would not be entitled to eighth priority under section 507(a)(8)(A)(i) because the date on which *B*'s 2004 income tax return is last due, including extensions, is April 15, 2005, which precedes September 1, 2005, the date that is three years before the filing of the bankruptcy petition. Accordingly, *B*'s 2004 income tax liability is not excepted from discharge under section 523(a)(1)(A) of the Bankruptcy Code.

The date on which *B*'s 2004 income tax return is "last due, under applicable law or under any extension" under section 523(a)(1)(B)(ii) of the Bankruptcy Code is likewise unaffected by the section 7508 relief. Because *B*'s 2004 return is filed after April 15, 2005, the date on which the return is "last due, under applicable law or under any extension" and because the date of the petition (September 1, 2008) is less than two years from the date on which the 2004 return is filed (September 20, 2006), the 2004 income tax liability is excepted from discharge under sections 523(a)(1)(B)(ii) and 727(b) of the Bankruptcy Code.

HOLDINGS

(1) The Service's grant of relief under section 7508A of the Code, which postpones the time in which a taxpayer affected by a Presidentially-declared disaster may timely file an income tax return, does not change the date on which a return is "last due, including extensions" under section 507(a)(8)(A)(i) of the Bankruptcy Code. This holding would also apply to an "affected taxpayer" other than an individual under section 301.7508A–1(d)(1) of the Procedure and Administration Regulations.

(2) Section 7508 relief, which postpones the time in which an individual

may timely file an income tax return, does not change the date on which the return is "last due, including extensions" under section 507(a)(8)(A)(i) of the Bankruptcy Code or "last due, under applicable law or under any extension" under section 523(a)(1)(B)(ii) of the Bankruptcy Code.

DRAFTING INFORMATION

The principal author of this revenue ruling is Micah A. Levy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Micah A. Levy at (202) 622–3620 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Hurricane Katrina Disaster Relief and Bankruptcy

Notice 2007–74

PURPOSE

This notice clarifies Notice 2006–56, 2006–28 I.R.B. 58, which, under the authority of section 7508A of the Internal Revenue Code, postponed until October 16, 2006 the time for certain individuals affected by Hurricane Katrina to file 2005 income tax returns (among other things). Notice 2006–56 also provided that the filing period would be postponed until April 15, 2007 for taxpayers who, under I.R.C. section 6081, requested an extension of time to file their 2005 returns prior to October 16, 2006.

Revenue Ruling 2007–59 held that the Internal Revenue Service's grant of relief under section 7508A does not change the date on which a return is "last due, including extensions" for purposes of Bankruptcy Code sections 507(a)(8)(A)(i) and 523(a)(1)(A), which provide priority and nondischargeability for certain tax claims in bankruptcy cases. Questions have arisen as to the date on which the 2005 return would be "last due, including extensions" if an affected taxpayer receives relief under section 7508A, obtains an extension of time to file under section 6081 within the 7508A postponement period, and files bankruptcy.

Bankruptcy Effect of Section 7508A Relief and Section 6081 Extension

Unlike the postponement of time under section 7508A, the grant of a request for extension under section 6081 changes the date on which a return is "last due, including extensions" for purposes of Bankruptcy Code sections 507(a)(8)(A)(i) and 523(a)(1)(A). *See In re McDermott*, 286 B.R. 913 (M.D. Fla. 2002). If an affected taxpayer under Notice 2006–56 requested an extension of time to file 2005 income taxes within the section 7508A postponement period, the return would be considered in a later bankruptcy case to be "last due, including extensions" on October 15, 2006, six months after the original due date. October 15, 2006 will therefore be the determinative date for priority and dischargeability purposes of 2005 taxes under Bankruptcy Code sections 507(a)(8)(A)(i) and 523(a)(1)(A).

EFFECT ON OTHER DOCUMENTS

This document amplifies Revenue Ruling 2007–59 and clarifies Notice 2006–56.

DRAFTING INFORMATION

The principal author of this notice is Micah A. Levy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact Micah A. Levy at (202) 622–3620 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of tax liability.

Rev. Proc. 2007–58

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 2005. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2005. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2004, see Rev. Proc. 2006–39, 2006–40 I.R.B. 600.

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2006. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 2005, the relevant domestic asset/liability percentages are:

151.6 percent for foreign life insurance companies, and

192.7 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2006. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 2005, the relevant domestic investment yields are:

4.5 percent for foreign life insurance companies, and

3.3 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2006. The section 842(b) percentages to be used for the 2006 tax year are based on tax return data following the same methodology used for the 2005 year.

SECTION 3. APPLICATION-ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 2005, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of

this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2006–39 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2005.

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Sheila Ramaswamy of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Sheila Ramaswamy at (202) 622–3870 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Severance of a Trust for Generation-Skipping Transfer (GST) Tax Purposes II

REG–128843–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance regarding the generation-skipping transfer (GST) tax consequences of the severance of trusts in a manner that is effective under state law, but that does not meet the requirements of a qualified severance under section 2642(a)(3) of the Internal Revenue Code. These proposed regulations also provide guidance regarding the GST tax consequences of a qualified severance of a trust with an inclusion ratio between zero and one into more than two resulting trusts. These proposed regulations also provide special funding rules applicable to the non-*pro rata* division of certain assets between or among resulting trusts. The regulations will affect trusts that are subject to the GST tax.

DATES: Written or electronic comments and requests for a public hearing must be received by October 31, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–128843–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–128843–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–128843–05).

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels, (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 24, 2004, proposed regulations under section 2642(a)(3) regarding qualified severances were published in the **Federal Register** (REG–145987–03, 2004–2 C.B. 519 [69 FR 51967]). Final regulations were published on August 2, 2007. The Treasury Department and the IRS determined that certain comments received in response to the proposed regulations under section 2642(a)(3) should be addressed in a separate notice of proposed rulemaking, instead of in the final regulations published on August 2, 2007. Accordingly, this notice of proposed rulemaking proposes additional changes to the regulations in response to those comments.

Section 2642(a)(3) was added to the Internal Revenue Code (Code) by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Public Law 107–16 (115 Stat. 38 (2001)). Under section 2642(a)(3), if a trust is divided into two or more trusts in a "qualified severance," the trusts resulting from the severance (resulting trusts), which may have different inclusion ratios, will be recognized as separate trusts for GST tax purposes. Once the resulting trusts are recognized as separate trusts, the transferor's lifetime GST tax exemption may be allocated separately to either trust. In addition, whether or not a GST taxable event occurs is determined separately for each resulting trust.

One commentator with respect to the notice of proposed rulemaking under section 2642(a)(3) suggested that those regulations should expressly address the GST tax consequences of dividing a trust in a manner that does not satisfy the regulatory requirements of a qualified severance, but nonetheless is effective to create separate trusts under applicable state law. Specifically, the commentator requested that the regulations be amended to provide that the separate trusts created as the result of a trust's division that is effective under state law, but that does not qualify as a qualified severance, will be respected prospectively as separate trusts for GST tax purposes, but that the inclusion ratio of each of the resulting trusts will be the same as the inclusion ratio of the original trust immediately before its severance.

As noted by a commentator, however, such a result would require an amendment to the existing regulations under section 2654. Generally, section 2654(b)(2) provides that "substantially separate and independent shares" of different beneficiaries in a trust will be treated as separate trusts for GST tax purposes. Section 26.2654–1(a)(1)(i) provides that, for purposes of section 2654(b)(2), the term "substantially separate and independent shares" generally has the same meaning as provided in §1.663(c)(3). However, these regulations further provide that a portion of a trust is not a separate share "unless such share exists from and at all times after creation of the trust."

Section 26.2654–1(a)(5), *Example 8*, illustrates this rule. In *Example 8*, T creates a discretionary trust with discretionary power in the trustee to distribute income and principal among T's children and grandchildren. The trust agreement directs that, when T's youngest child reaches age 21, the trust be divided into separate shares, with one such share for each child of T; the income from a particular share is to be paid to T's child (for whom that share was created) for life, with the remainder from that share to be distributed to that child's own children. The example concludes that the separate shares that come into existence when the youngest child reaches age 21 are not recognized as separate trusts for GST tax purposes because the separate shares did not constitute separate and independent shares of a single trust at all times from the date of creation of the original trust, as required by §26.2654–1(a)(1). Thus, any allocation of GST tax exemption to the original trust, or to any of the separate shares after the division, will apply with respect to the entire trust. The example provides that the result would be the same if the original trust was divided into separate trusts rather than separate shares.

Another commentator with respect to the notice of proposed rulemaking under section 2642(a)(3) requested that the regulations provide additional flexibility in severing a trust that has an inclusion ratio between zero and one. Generally, the final

regulations apply section 2642(a)(3)(B)(ii) by requiring that the trust first be severed into two identical trusts, one of which would then have an inclusion ratio of zero and the other an inclusion ratio of one. The final regulations confirm that either or both of these trusts may then be further severed into a trust for the benefit of the skip person(s) and a trust for the benefit of the non-skip person(s). However, under this two-step procedure, one of the resulting trusts for the benefit of skip persons would have an inclusion ratio of one, and one of the trusts for the benefit of the non-skip persons would have an inclusion ratio of zero. The commentator requested that the regulations allow severances in a manner that would permit a more effective utilization of the exemption.

The Treasury Department and the IRS believe that each of these suggestions merits further consideration in a new notice of proposed rulemaking. In addition, the new proposed regulations clarify the rules in the final regulations regarding the funding of resulting trusts.

Explanation of Provisions

The proposed regulations amend the regulations under §26.2642–6 to provide that trusts resulting from a severance that does not meet the requirements of a qualified severance nevertheless will be treated, after the severance, as separate trusts for GST tax purposes, provided that the resulting trusts are recognized as separate trusts under applicable state law. Because the severance is not a qualified severance, each such resulting trust will have the same inclusion ratio immediately after the severance as the original trust immediately before the severance. Nevertheless, GST tax exemption allocated after the severance may be separately allocated to one or more of the resulting trusts, and the trusts will otherwise be treated as separate trusts for GST tax purposes. An example of a nonqualified severance is added to the regulations.

The proposed regulations also revise §26.2654–1(a)(1)(i) and (a)(5), *Example 8*.

In addition, pursuant to the authority granted in section 2642(a)(3)(B)(iii), these proposed regulations provide for an additional type of qualified severance. Specifically, the proposed regulations provide that a trust with an inclusion ratio between zero and one may be severed in a qualified severance into more than two resulting trusts. One or more of the resulting trusts in the aggregate must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction used to determine the inclusion ratio of the original trust immediately before the severance. The trust or trusts receiving such fractional share shall have an inclusion ratio of zero, and each of the other resulting trust or trusts shall have an inclusion ratio of one. Further, the trustee may designate the beneficiary of each separate resulting trust, provided that the designation results in each beneficiary having the same beneficial interest (within the meaning of §26.2642–6(d)(5)) after the severance as that beneficiary had in the original trust corpus. Guidance illustrating the application of this rule is included in §26.2642–6(d)(7)(ii) and *Example 9* of §26.2642–6(j) of these proposed regulations.

Finally, these proposed regulations clarify a provision of the final regulations (T.D. 9348) issued contemporaneously with these proposed regulations. Specifically, §26.2642–6(d)(4) requires that each resulting trust be funded with a fraction or percentage of the entire trust and that, although particular assets may be divided among the resulting trusts on a non-*pro rata* basis based on the fair market value of the assets on the date of severance, the sum of those fractions or percentages must be one or one hundred percent, respectively. Thus, if the resulting trusts are funded on a non-*pro rata* basis, the sum of the values distributed to the resulting trusts must equal the fair market value of the trust being severed. These proposed regulations clarify that no discounts or other reductions from the value of an asset owned by the original trust, arising by reason of the division of the original trust's interest in the asset between or among the resulting trusts, are permitted in funding the resulting trusts. Instead, solely for funding purposes, each resulting trust's interest in the stock of a closely held corporation, partnership interest, or other single asset must be valued by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fractional or percentage interest in that asset being distributed to that resulting trust. This clarification is proposed to be effective with respect to severances occurring on or after the date these proposed regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) applies only to §26.2642–6(d)(7)(ii) of these regulations. It is hereby certified that this provision will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required. This provision directly affects individuals, not entities. Because the remaining sections of these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the substance of the proposed regulations, as well as on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Mayer R. Samuels,

Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. Other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 26 is proposed to be amended as follows:

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Paragraph 1. The authority citation for part 26 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §26.2600–1, the table of contents is amended by adding the entry for §26.2642–6(h) to read as follows:

§26.2600–1 Table of contents.

* * * * *

§26.2642–6 Qualified severance.

* * * * *

(h) Treatment of trusts resulting from a severance that is not a qualified severance.

* * * * *

Par. 3. Section 26.2642–6 is amended as follows:

1. Paragraph (d)(4) and (d)(7) are revised.

2. Paragraph (h) is added.

3. Paragraph (j) *Examples 6*, *9*, *12*, and *13* are added.

4. Paragraph (k)(1) is revised.

The additions and revisions read as follows:

§26.2642–6 Qualified severance.

* * * * *

(d) * * *

(4) The single trust (original trust) is severed on a fractional basis, such that each new trust (resulting trust) is funded with a fraction or percentage of the original trust, and the sum of those fractions or percentages is one or one hundred percent, respectively. For this purpose, the fraction or percentage may be determined by means of a formula (for example, that fraction of the trust the numerator of which is equal to the transferor's unused GST tax exemption, and the denominator of which is the fair market value of the original trust's assets on the date of severance). The severance of a trust based on a pecuniary amount does not satisfy this requirement. For example, the severance of a trust is not a qualified severance if the trust is divided into two trusts, with one trust to be funded with $1,500,000 and the other trust to be funded with the balance of the original trust's assets. With respect to the particular assets to be distributed to each resulting trust, each resulting trust may be funded with the appropriate fraction or percentage (*pro rata* portion) of each asset held by the original trust. Alternatively, the assets may be divided among the resulting trusts on a non-*pro rata* basis, based on the fair market value of the assets on the date of severance. However, if a resulting trust is funded on a non-*pro rata* basis, each asset received by a resulting trust must be valued, solely for funding purposes, by multiplying the fair market value of the asset held in the original trust as of the date of severance by the fraction or percentage of that asset received by that resulting trust. Thus, the assets must be valued without taking into account any discount or premium arising from the severance, for example, any valuation discounts that might arise because the resulting trust receives less than the entire interest held by the original trust. See paragraph (j), *Example 6* of this section.

* * * * *

(7) In the case of a qualified severance occurring after GST tax exemption has been allocated to the trust (whether by an affirmative allocation, a deemed allocation, or an automatic allocation pursuant to the rules contained in section 2632), if the trust has an inclusion ratio as defined in §26.2642–1 that is greater than zero and less than one, then either paragraph (d)(7)(i) or (ii) of this section must be satisfied.

(i) The trust is severed initially into only two resulting trusts. One resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction, as defined in §26.2642–1(b) and (c), used to determine the inclusion ratio of the original trust immediately before the severance. The other resulting trust must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the excess of one over the fractional share described in the preceding sentence. The trust receiving the fractional share equal to the applicable fraction shall have an inclusion ratio of zero, and the other trust shall have an inclusion ratio of one. If the applicable fraction with respect to the original trust is .50, then, with respect to the two equal trusts resulting from the severance, the Trustee may designate which of the resulting trusts will have an inclusion ratio of zero and which will have an inclusion ratio of one. Each separate trust resulting from the severance then may be further divided in accordance with the rules of this section. See paragraph (j), *Example 7* of this section.

(ii) The trust is severed initially into more than two resulting trusts. One or more of the resulting trusts in the aggregate must receive that fractional share of the total value of the original trust as of the date of severance that is equal to the applicable fraction used to determine the inclusion ratio of the original trust immediately before the severance. The trust or trusts receiving such fractional share shall have an inclusion ratio of zero, and each of the other resulting trust or trusts shall have an inclusion ratio of one. (If, however, two or more of the resulting trusts each receives the fractional share of the total value of the original trust equal to the applicable fraction, the trustee may designate which of those resulting trusts will have an inclusion ratio of zero and which will have an inclusion ratio of one.) The resulting trust or trusts with an inclusion ratio of one must receive in the aggregate that fractional share of the total value of the original trust as of the date of severance that is equal to the excess of one over the fractional share described in the second sentence of this paragraph. See paragraph (j), *Example 9* of this section.

* * * * *

(h) *Treatment of trusts resulting from a severance that is not a qualified severance.* Trusts resulting from a severance (other than a severance under §26.2654–1) that does not meet the requirements of a qualified severance under paragraph (b) of this section will be treated, after the date of severance, as separate trusts for pur-

poses of the generation-skipping transfer (GST) tax, provided that the trusts resulting from such severance are recognized as separate trusts under applicable state law. The post-severance treatment of the resulting trusts as separate trusts for GST tax purposes generally permits the allocation of GST tax exemption, the making of various elections permitted for GST tax purposes, and the occurrence of a taxable distribution or termination with regard to a particular resulting trust, with no GST tax impact on any other trust resulting from that severance. Each trust resulting from a severance described in this paragraph, however, will have the same inclusion ratio immediately after the severance as that of the original trust immediately before the severance. (See §26.2654–1 for the inclusion ratio of each trust resulting from a severance described in that section.)

* * * * *

(j) * * *

Example 6. Funding of severed trusts on a non-pro rata basis. T's will establishes an irrevocable trust, Trust, for the benefit of T's descendants. As a result of the allocation of GST tax exemption, the applicable fraction with respect to Trust is .60 and Trust's inclusion ratio is .40 [1 - .60]. Pursuant to authority granted under applicable state law, on August 1, 2008, the trustee executes a document severing Trust into two trusts, Trust 1 and Trust 2, each of which is identical to Trust. The instrument of severance provides that the severance is intended to qualify as a qualified severance within the meaning of section 2642(a)(3) and designates August 3, 2008, as the date of severance (within the meaning of paragraph (d)(3) of this section). The instrument further provides that Trust 1 and Trust 2 are to be funded on a non-*pro rata* basis with Trust 1 funded with assets having a fair market value on the date of severance equal to 40% of the value of Trust's assets on that date and Trust 2 funded with assets having a fair market value equal to 60% of the value of Trust's assets on that date. The fair market value of the assets used to fund each trust is to be determined in compliance with the requirements of paragraph (d)(4) of this section. On August 3, 2008, the fair market value of the Trust assets totals $4,000,000, consisting of 52% of the outstanding common stock in Company, a closely-held corporation, valued at $3,000,000 and $1,000,000 in cash and marketable securities. Trustee proposes to divide the Company stock equally between Trust 1 and Trust 2, and thus transfer 26% of the Company stock to Trust 1 and 26% of the stock to Trust 2. In addition, the appropriate amount of cash and marketable securities will be distributed to each trust. In accordance with paragraph (d)(4) of this section, for funding purposes, the interest in the Company stock distributed to each trust is valued as a *pro rata* portion of the value of the 52% interest in Company held by Trust before severance, without taking into account, for example, any valuation discount that might otherwise apply in valuing the noncontrolling interest distributed to each resulting trust. Accordingly, for funding purposes, each 26% interest in Company stock distributed to Trust 1 and Trust 2 is valued at $1,500,000 (.5 x $3,000,000). Therefore, Trust 1, which is to be funded with $1,600,000 (.40 x $4,000,000), receives $100,000 in cash and marketable securities valued as of August 3, 2008, in addition to the Company stock, and Trust 2, which is to be funded with $2,400,000 (.60 x $4,000,000), receives $900,000 in cash and marketable securities in addition to the Company stock. Therefore, the severance is a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied.

* * * * *

Example 9. Regulatory qualified severance. In 2004, T establishes an *inter vivos* irrevocable trust (Trust) providing that Trust income is to be paid annually in equal shares to T's children, A and B, for 10 years. If either (or both) dies prior to the expiration of the 10-year term, the deceased child's share of trust income is to be paid to the child's then living descendants, per stirpes, for the balance of the trust term. At the expiration of the 10-year trust term, the corpus is to be distributed equally to A and B; if A and B (or either or them) is not then living, then such decedent's share is to be distributed instead to such decedent's then living descendants, per stirpes. T allocates GST tax exemption to Trust such that Trust's applicable fraction is .25 and its inclusion ratio is .75. In 2006, pursuant to applicable state law, the trustee severs the trust into three trusts: Trust 1, Trust 2, and Trust 3. The instrument severing Trust provides that Trust 1 is to receive 50% of Trust's assets, Trust 2 is to receive 25% of Trust's assets, and Trust 3 is to receive 25% of Trust's assets. All three resulting trusts are identical to Trust, except that each has different beneficiaries: A and A's issue are designated as the beneficiaries of Trust 1, and B and B's issue are designated as the beneficiaries of Trust 2 and Trust 3. The severance constitutes a qualified severance, provided that all other requirements of section 2642(a)(3) and this section are satisfied. Trust 1 will have an inclusion ratio of 1. Because both Trust 2 and Trust 3 have each received the fractional share of Trust's assets equal to Trust's applicable fraction of .25, trustee designates that Trust 2 will have an inclusion ratio of one and that Trust 3 will have an inclusion ratio of zero.

* * * * *

Example 12. Mandatory severance that does not qualify as a qualified severance. In 1996, T creates an irrevocable *inter vivos* trust (Trust) that provides the trustee with the discretionary power to distribute income or corpus from time to time to one or more of T's children and grandchildren. Trust provides that, when T's youngest child reaches age 30, Trust is to be divided equally into separate trusts (resulting trusts), with one resulting trust for each child of T who is then living, and one resulting trust for each child of T who is then deceased and who has then living descendants. The income from a child's resulting trust will be paid to that child during the child's life, with the remainder passing to such child's descendants (grandchildren and younger generation descendants of T). On a timely filed Form 709, "*United States Gift (and Generation-Skipping Transfer) Tax Return,*" reporting the transfer, T allocates all of T's remaining GST tax exemption to Trust. As a result of the allocation, the applicable fraction with respect to Trust is .20, so Trust's inclusion ratio is .80 [1 -.20]. T's youngest child reaches age 30 in 2008. (No additional gifts are made through 2008 and Trust's inclusion ratio does not change.) In accordance with Trust's terms, Trust is divided in 2008 into three separate trusts (Trust 1, Trust 2, and Trust 3), one trust for each of T's three children, each of whom is then living. Trust 1, Trust 2, and Trust 3 are each recognized as a separate trust under applicable state law. With the consent of all interested parties, each resulting trust is funded with assets different from the assets distributed to the other two resulting trusts in a manner that does not meet the requirements of paragraph (d)(3) of this section. As a result, the severance does not satisfy the requirements of a qualified severance under this section. Under paragraph (h) of this section, however, Trust 1, Trust 2, and Trust 3 are each recognized as a separate trust for GST tax purposes prospectively from the date of severance, because the severance was effective to create three separate trusts under applicable state law. Therefore, after the severance, if T becomes entitled to any additional GST tax exemption pursuant to subsequent changes in applicable Federal tax law, T may allocate that additional GST tax exemption to any one or more of these three resulting trusts. Because the severance is not a qualified severance, however, the inclusion ratio of each of the three new trusts immediately after the severance will be .80, the same as Trust's inclusion ratio immediately before the severance.

Example 13. Other severance that does not qualify as a qualified severance. In 2004, T establishes an irrevocable *inter vivos* trust (Trust) providing that Trust income is to be paid to T's children, A and B, in equal shares for their joint lives. Upon the death of the first to die of A and B, all Trust income will be paid to the survivor of A and B. At the death of the survivor, the corpus is to be distributed in equal shares to T's grandchildren, W and X (with any then-deceased grandchild's share being paid in accordance with that grandchild's testamentary general power of appointment). W is A's child and X is B's child. T elects under section 2632(c)(5) not to have the automatic allocation rules contained in section 2632(c) apply with respect to T's transfers to Trust, and T does not otherwise allocate GST tax exemption to Trust. In 2006, the trustee of Trust, as permitted by applicable state law, divides Trust into two separate trusts, Trust 1 and Trust 2. Trust 1 provides that trust income is to be paid to A for life and, on A's death, the remainder is to be distributed to W (or pursuant to W's testamentary general power of appointment). Trust 2 provides that trust income is to be paid to B for life and, on B's death, the remainder is to be distributed to X (or pursuant to X's testamentary general power of appointment). Because Trust 1 and Trust 2 do not provide A and B with the contingent survivor income interests that were provided to A and B under the terms of Trust, Trust 1 and Trust 2 do not provide for the same succession of interests in the aggregate as provided by Trust. Therefore, the severance does not satisfy the requirements of this section and is not a qualified severance. However, under paragraph (h) of this section, provided that Trust 1 and Trust 2 are recognized as separate trusts under applicable state law, Trust 1 and Trust 2 will be recognized as separate trusts for GST tax purposes, prospectively from the date of the severance. Trust 1

and Trust 2 each have the same inclusion ratio immediately after the severance as Trust's inclusion ratio immediately before the severance.

(k) * * *

(1) *In general.* Except as otherwise provided, this section applies to severances occurring on or after August 2, 2007. Paragraph (d)(7)(ii), paragraph (h), and *Examples 9, 12,* and *13* of paragraph (j) of this section apply to severances occurring on or after August 2, 2007. Paragraph (d)(4) and *Example 6* of paragraph (j) apply to severances occurring on or after August 2, 2007.

Par. 4. Section 26.2654–1 is amended as follows:

1. Paragraph (a)(1)(i) is revised.
2. A new paragraph (a)(1)(iii) is added.
3. In paragraph (a)(5), *Example 8* is revised.

The additions and revisions read as follows:

§26.2654–1 Certain trusts treated as separate trusts.

(a) *Single trust treated as separate trusts*—(1) *Substantially separate and independent shares*—(i) *In general.* If a single trust consists solely of substantially separate and independent shares for different beneficiaries, the share attributable to each beneficiary (or group of beneficiaries) is treated as a separate trust for purposes of chapter 13. The phrase "substantially separate and independent shares" generally has the same meaning as provided in §1.663(c)–3 of this chapter. However, except as provided in paragraph (a)(1)(iii) of this section, a portion of a trust is not a separate share unless such share exists from and at all times after the creation of the trust. For purposes of this paragraph (a)(1), a trust is treated as created at the date of death of the grantor if the trust is includible in its entirety in the grantor's gross estate for Federal estate tax purposes. Further, treatment of a single trust as separate trusts under this paragraph (a)(1) does not permit treatment of those portions as separate trusts for purposes of filing returns and payment of tax or for purposes of computing any other tax imposed under the Internal Revenue Code. Also, additions to, and distributions from, such trusts are allocated *pro rata* among the separate trusts, unless the governing instrument expressly provides otherwise. See §26.2642–6 and paragraph (b) of this section regarding the treatment, for purposes of chapter 13, of separate trusts resulting from the actual severance of a single trust.

* * * * *

(iii) *Mandatory severances.* For purposes of this section, if the governing instrument of a trust requires the division or severance of a single trust into separate trusts upon the future occurrence of a particular event not within the discretion of the trustee or any other person, and if the trusts resulting from such a division or severance are recognized as separate trusts under applicable state law, then each resulting trust is treated as a separate trust for purposes of chapter 13. For this purpose, the rules of paragraph (b)(1)(ii)(C) of this section apply with respect to the severance and funding of the trusts. Similarly, if the governing instrument requires the division of a single trust into separate shares under the circumstances described in this paragraph, each such resulting share is treated as a separate trust for purposes of chapter 13. The post-severance treatment of the resulting trusts or shares as separate trusts for GST tax purposes generally permits the allocation of GST tax exemption, the making of various elections permitted for GST tax purposes, and the occurrence of a taxable distribution or termination with regard to a particular resulting trust or share, with no GST tax impact on any other trust or share resulting from that severance. The treatment of a single trust as separate trusts under this paragraph (a)(1), however, does not permit treatment of those portions as separate trusts for purposes of filing returns and payment of tax or for purposes of computing any other tax imposed under the Internal Revenue Code. Also, additions to, and distributions from, such trusts are allocated *pro rata* among the separate trusts, unless the governing instrument expressly provides otherwise. Each separate share and each trust resulting from a mandatory division or severance described in this paragraph will have the same inclusion ratio immediately after the severance as that of the original trust immediately before the division or severance.

* * * * *

(5) * * *

Example 8. Subsequent mandatory division into separate trusts. T creates an irrevocable trust that provides the trustee with the discretionary power to distribute income or corpus to T's children and grandchildren. The trust provides that, when T's youngest child reaches age 21, the trust will be divided into separate shares, one share for each child of T. The income from a respective child's share will be paid to the child during the child's life, with the remainder passing on the child's death to such child's children (grandchildren of T). The separate shares that come into existence when the youngest child reaches age 21 will be recognized as of that date as separate trusts for purposes of Chapter 13. Any allocation of GST tax exemption to the trust after T's youngest child reaches age 21 may be made to any one or more of the separate shares. The result would be the same if the trust instrument provided that the trust was to be divided into separate trusts when T's youngest child reached age 21, provided that the severance and funding of the separate trusts meets the requirements of this section.

* * * * *

Linda E. Stiff,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 1, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 2, 2007, 72 F.R. 42340)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Clarification to Section 6411 Regulations

REG–118886–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9335) relating to the computation and allowance of the tentative carryback adjustment under section 6411 of the Internal Revenue Code. Those temporary regulations clarify that for purposes of allowing the tentative adjustment, the IRS may credit or reduce the tentative adjustment by an assessed tax liability, whether or not that tax liability was assessed before the date the application for tentative carryback is filed, and other unassessed liabilities in

certain other circumstances. Those regulations also remove all references to IRS district director or service center director, as these positions no longer exist within the IRS. The offices of the district director and service center director were eliminated by the IRS reorganization implemented pursuant to the IRS Reform and Restructuring Act of 1998. The text of the temporary regulations serves as the text of these proposed regulations.

DATES: Written and electronic comments and requests for a public hearing must be received by November 26, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–118886–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–118886–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–118886–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Cynthia A. McGreevy, (202) 622–4910; concerning submissions of comments, Richard Hurst, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

These proposed regulations clarify the Income Tax Regulations (26 CFR part 1) under section 6411 relating to the computation and allowance of the tentative carryback adjustment. The tentative allowance is computed pursuant to §1.6411–2 but applied pursuant to §1.6411–3. These regulations clarify that for purposes of computing the allowance, the Commissioner will not consider amounts to which the taxpayer and the Commissioner are in disagreement. For purposes of applying the allowance, however, the Commissioner may credit or reduce the tentative adjustment by any assessed tax liabilities, unassessed liabilities determined in a statutory notice of deficiency, unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, and other unassessed liabilities in rare and unusual circumstances. Regarding unassessed liabilities determined in a statutory notice of deficiency, see Rev. Rul. 2007–51. Regarding unassessed liabilities identified in a proof of claim filed in a bankruptcy proceeding, see Rev. Rul. 2007–52. See §601.601(d)(2). The IRS plans to adopt procedures requiring IRS National Office review prior to a credit or reduction of the tentative adjustment by an unassessed liability that constitutes a rare and unusual circumstance.

In this issue of the Bulletin, the IRS is issuing temporary regulations relating to the computation and allowance of the tentative carryback adjustment under section 6411 of the Internal Revenue Code. The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Proposed Effective Date

These proposed amendments to §§1.6411–2 and 1.6411–3 apply with respect to applications for tentative refund filed on or after the date these rules are published as final regulations in the **Federal Register**. No implication is intended concerning whether or not a rule to be adopted in these regulations is applicable law for applications filed prior to that date.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person who timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Cynthia A. McGreevy of the Office of the Associate Chief Counsel (Procedure and Administration).

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6411–2 is revised to read as follows:

§1.6411–2 Computation of tentative carryback adjustment.

(a) [The text of proposed §1.6411–2(a) is the same as the text of §1.6411–2T(a) published elsewhere in this issue of the Bulletin].

(b) [The text of proposed §1.6411–2(b) is the same as the text of §1.6411–2T(b) published elsewhere in this issue of the Bulletin].

* * * * *

Par. 3. Section 1.6411–3 is revised to read as follows:

§1.6411–3 Allowance of adjustments.

(a) [The text of proposed §1.6411–3(a) is the same as the text of §1.6411–3T(a) published elsewhere in this issue of the Bulletin].

(b) [The text of proposed §1.6411–3(b) is the same as the text of §1.6411–3T(b) published elsewhere in this issue of the Bulletin].

(c) [The text of proposed §1.6411–3(c) is the same as the text of §1.6411–3T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of proposed §1.6411–3(d) is the same as the text of §1.6411–3T(d) published elsewhere in this issue of the Bulletin].

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 27, 2007, 72 F.R. 48952)

Notice of Proposed Rulemaking

Diversification Requirements for Variable Annuity, Endowment, and Life Insurance Contracts

REG–118719–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: This document proposes changes to the regulations concerning the diversification requirements of section 817(h) of the Internal Revenue Code (Code). The proposed changes would expand the list of holders whose beneficial interests in an investment company, partnership, or trust do not prevent a segregated asset account from looking through to the assets of the investment company, partnership, or trust, to satisfy the requirements of section 817(h). The proposed regulations also would remove the sentence in §1.817–5(a)(2) that provides that the payment required to remedy an inadvertent diversification failure must be based on the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract. These proposed regulations would affect insurance companies that issue variable contracts and would affect policyholders who purchase such contracts.

DATES: Written or electronic comments and requests for a public hearing must be received by October 29, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–118719–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–118719–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–118719–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, James Polfer, at (202) 622–3970 (not a toll-free number).

Concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, e-mail *Richard.A.Hurst@irscousel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Background

Section 817(d) defines a variable contract for purposes of part I of subchapter L of the Code (sections 801–818). For a contract to be a variable contract, it must provide for the allocation of all or a part of the amounts received under the contract to an account that, pursuant to state law or regulation, is segregated from the general asset accounts of the issuing insurance company. In addition, for a life insurance contract to be a variable contract, it must qualify as a life insurance contract for Federal income tax purposes, and the amount of the death benefits (or the period of coverage) must be adjusted on the basis of the investment return and the market value of the segregated asset account; for an annuity contract to be a variable contract, it must provide for the payment of annuities, and the amounts paid in, or the amount paid out, must reflect the investment return and the market value of the segregated asset account; for a contract that provides funding of insurance on retired lives to be a variable contract, the amounts paid in, or the amounts paid out, must reflect the investment return and the market value of the segregated asset account.

Section 817(h)(1) provides that a variable contract that is based on a segregated asset account is not treated as an annuity, endowment, or life insurance contract unless the segregated asset account is adequately diversified in accordance with regulations prescribed by the Secretary. If a segregated asset account is not adequately diversified for a calendar quarter, then the contracts supported by that segregated asset account are not treated as annuity, endowment, or life insurance contracts for that period and subsequent periods, even if the segregated asset account is adequately diversified in those subsequent periods. Under §1.817–5(a), if a segregated asset account is not adequately diversified, income earned by that segregated asset account is treated as ordinary income received or accrued by the policyholders. Section 1.817–5(a)(2) provides conditions an issuer of a variable contract must satisfy in order to correct an inadvertent failure to diversify. Rev. Proc. 92–25, 1992–1 C.B. 741, see §601.601(d)(2) of this chapter, sets forth in more detail the procedure by which an issuer may request the relief described in §1.817–5(a)(2).

Congress enacted the diversification requirements of section 817(h) to "discourage the use of tax-preferred variable annuity and variable life insurance primarily as investment vehicles." H.R. Conf. Rep. No. 98–861, at 1055 (1984). In section 817(h)(1), Congress granted the Secretary broad regulatory authority to develop rules to carry out this intent. Congress directed that these standards be imposed because "by limiting a customer's ability to select specific investments underlying a variable contract, [adequate diversification] will help ensure that a customer's primary motivation in purchasing the contract is more likely to be the traditional economic

protections provided by annuities and life insurance." S. Prt. 98–169, Vol. I at 546 (1984). A primary directive from Congress to Treasury in enacting the standards was to "deny annuity or life insurance treatment for investments that are publicly available to investors." H.R. Conf. Rep. No. 98–861, at 1055 (1984).

Section 817(h)(4) provides a look-through rule under which taxpayers do not treat the interest in a regulated investment company (RIC) or trust as a single asset of the segregated asset account but rather apply the diversification tests by taking into account the assets of the RIC or trust. Section 817(h) further provides that the look-through rule applies only if all of the beneficial interests in a RIC or trust are held by one or more insurance companies (or affiliated companies) in their general account or segregated asset accounts, or by fund managers (or affiliated companies) in connection with the creation or management of the RIC or trust.

Under §1.817–5(f)(1), if look-through treatment is available, a beneficial interest in a RIC, real estate investment trust, partnership, or trust that is treated under sections 671 through 679 as owned by the grantor or another person ("investment company, partnership or trust") is not treated as a single investment of a segregated asset account for purposes of testing diversification. Instead, a *pro rata* portion of each asset of the investment company, partnership, or trust is treated as an asset of the segregated asset account. Section 1.817–5(f)(2)(i) provides that the look-through rule applies to any investment company, partnership, or trust if (1) all the beneficial interests in the investment company, partnership, or trust are held by one or more segregated asset accounts of one or more insurance companies; and (2) public access to the investment company, partnership, or trust is available exclusively through the purchase of a variable contract (except as otherwise permitted in §1.817–5(f)(3)).

Under §1.817–5(f)(3), look-through treatment is not prevented by reason of beneficial interests in an investment company, partnership, or trust that are

(1) Held by the general account of a life insurance company or a corporation related to a life insurance company, but only if the return on such interests is computed in the same manner as the return on an interest held by a segregated asset account is computed, there is no intent to sell such interests to the public, and a segregated asset account of such life insurance company also holds or will hold a beneficial interest in the investment company, partnership, or trust;

(2) Held by the manager, or a corporation related to the manager, of the investment company, partnership or trust, but only if the holding of the interests is in connection with the creation or management of the investment company, partnership or trust, the return on such interest is computed in the same manner as the return on an interest held by a segregated asset account is computed, and there is no intent to sell such interests to the public;

(3) Held by the trustee of a qualified pension or retirement plan; or

(4) Held by the public, or treated as owned by the policyholders pursuant to Rev. Rul. 81–225, 1981–2 C.B. 12, see §601.601(d)(2) of this chapter, but only if (A) the investment company, partnership or trust was closed to the public in accordance with Rev. Rul. 82–55, 1982–1 C.B. 12, see §601.601(d)(2) of this chapter, or (B) all the assets of the segregated asset account are attributable to premium payments made by policyholders before September 26, 1981, to premium payments made in connection with a qualified pension or retirement plan, or to any combination of such premium payments.

Explanation of Provisions

This document contains proposed amendments to 26 CFR part 1 under section 817(h).

The amendments would remove the sentence from §1.817–5(a)(2) which provides that the amount required to be paid to remedy an inadvertent failure to diversify must be based on the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract for the period or periods of nondiversification.

The amendments also would expand the list of permitted investors in §1.817–5(f)(3) to include (i) qualified tuition programs as defined in section 529, (ii) trustees of foreign pension plans established and maintained outside the United States, primarily for the benefit of individuals, substantially all of whom are nonresident aliens, and (iii) accounts that, pursuant to Puerto Rican law or regulation, are segregated from the general asset accounts of the life insurance companies that own the accounts, provided the requirements of section 817(d) and (h) are satisfied (without regard to the requirement the accounts be segregated pursuant to "State" law or regulation).

Reasons for Change

1. *Proposed amendment to §1.817–5(a)(2) (remedy for inadvertent nondiversification.*

The proposed regulations would remove the sentence in §1.817–5(a)(2) that provides that the payment required to remedy an inadvertent diversification failure must be based on the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract. In Notice 2007–15, 2007–7 I.R.B. 503 (February 12, 2007), the IRS requested comments on how various correction procedures, including those described in §1.817–5(a)(2) and Rev. Proc. 92–25, may be improved. Section 5.03(e) and (f) of the notice specifically requested comments on the computation of the amounts required to be paid under these correction procedures. Moreover, in the past, the provision in §1.817–5(a)(2) of the amount required to be paid has caused confusion about the scope of the IRS's authority to provide for amounts that depart from the plain language of the regulation. See, for example, Notice 2000–9, 2000–1 C.B. 449 (reduced amount applied for a limited period of time in the case of failures due to investments in U.S. Treasury securities). See §601.601(d)(2) of this chapter.

Even with the proposed modification of §1.817–5(a)(2), the amount required to be paid to remedy an inadvertent failure to diversify remains the amount set forth in Rev. Proc. 92–25, section 4.02. The modification of §1.817–5(a)(2) will preserve flexibility, however, should the IRS choose to modify this amount by publication in the Internal Revenue Bulletin in response to comments on Notice 2007–15.

2. *Expansion of list of permitted investors under §1.817–5(f)(3).*

On July 30, 2003, the Treasury Department and the IRS published a notice of

proposed rulemaking (REG–163974–02, 2003–2 C.B. 595) under section 817 in the **Federal Register** (68 FR 44689), proposing to remove a specific rule that applied to nonregistered partnerships for purposes of testing diversification. Written comments were received both on the proposed regulations and on the need for further guidance under section 817 more generally. Comments on the proposed regulations were taken into account in final regulations (T.D. 9185, 2005–1 C.B. 749) that were published March 1, 2005 in the **Federal Register** (70 FR 9869). Comments on section 817 more generally covered a broad range of issues. Two of those issues have since been addressed by revenue ruling. See Rev. Rul. 2005–7, 2005–1 C.B. 464 (concerning application of the look-through rule in the case of tiered regulated investment companies); Rev. Rul. 2007–7, 2007–7 I.R.B. 468 (February 12, 2007) (concluding that an interest held by a permitted investor is not treated as an interest held by the general public for purposes of Rev. Rul. 2003–92, 2003–2 C.B. 350).

These proposed regulations would expand the list of permitted investors in §1.817–5(f)(3) to include two categories of holders that were the subject of comments in 2003: (i) qualified tuition programs as defined in section 529, and (ii) trustees of pension or retirement plans established and maintained outside of the United States primarily for the benefit of individuals substantially all of whom are nonresident aliens.

Section 529 provides for the exemption from Federal income tax of qualified tuition programs. The term "*qualified tuition program*" means a program established and maintained by a state or agency or instrumentality thereof or by one or more eligible educational institutions (A) under which a person (i) may purchase tuition credits or certificates on behalf of a designated beneficiary which entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary, or (ii) in the case of a program established and maintained by a State or agency or instrumentality thereof, may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account, and (B) which meets the other requirements of section 529(b).

The Treasury Department and the IRS agree with the 2003 commentators that permitting qualified tuition programs and certain trustees of foreign pension plans to own a beneficial interest in an investment company, partnership, or trust that is also owned by one or more segregated asset accounts would be consistent with the purpose and operation of section 817(h). In addition, neither qualified tuition programs nor the foreign pension plans that are described in the proposed regulations present the possibility of investment by the general public, as that term is used in Rev. Rul. 81–225, 1981–2 C.B. 12, and Rev. Rul. 2003–92. See also Rev. Rul. 2007–7. The inclusion of qualified tuition programs in the list of permitted investors in §1.817–5(f)(3) does not relieve those programs of the need to satisfy all requirements of section 529 and the regulations under that section. In particular, the inclusion of such programs does not imply that an investment in a single investment company, partnership, or trust satisfying the minimum diversification requirements of §1.817–5(b) would necessarily be treated as a permitted investment under section 529, whether as a "broad-based investment strategy" within the meaning of Notice 2001–55, 2001–2 C.B. 299, or otherwise. The Treasury Department and the IRS will continue to evaluate other comments received in this area for future guidance by publication in the Internal Revenue Bulletin.

Finally, the proposed regulations would expand the list of permitted investors in §1.817–5(f)(3) to include investment by an account which, pursuant to Puerto Rican law or regulation, is segregated from the general asset accounts of the life insurance company that owns the account, provided the requirements of section 817(d) and (h) are satisfied (without regard to the requirement that the account be segregated pursuant to "State" law or regulation). The Treasury Department and the IRS have received a number of requests for guidance interpreting the term "*variable contract*" to include a contract issued by a Puerto Rican company, based on accounts that are segregated under Puerto Rican law or regulation. One reason for these requests is to ensure that a beneficial interest held by a Puerto Rican company in an investment company, partnership, or trust does not prevent look-through treatment for the other holders of an interest in the same investment, company, partnership, or trust under §1.817–5(f)(2). The Treasury Department and the IRS believe that expanding the list of permitted investors as proposed would address this issue without implicating the interpretive question of what constitutes a "State" within the meaning of sections 817(d) and 7701(a)(10).

Proposed Effective Date

The Treasury Department and the IRS intend these regulations to be effective on the date the final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. In addition to comments on the proposed regulations more generally, the Treasury Department and the IRS specifically request comments on (i) the clarity of the proposed regulations and how they can be made easier to understand; and (ii) whether rules similar to those proposed to apply to accounts that are segregated pursuant to Puerto Rican law or regulation should apply to accounts that are segregated pursuant to the laws or regulations of other territories.

All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is James Polfer, Office of the Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service. However, personnel from other offices of the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAX

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.817–5 also issued under 26 U.S.C. 817(h). * * *

Par. 2. Section 1.817–5 is amended as follows:

1. The last sentence of paragraph (a)(2)(iii) is removed.

2. Paragraph (f)(3)(iii) is revised.

3. Paragraph (f)(3)(iv) is redesignated as paragraph (f)(3)(vii).

4. New paragraphs (f)(3)(iv) through (vi) are added.

The revisions and additions read as follows:

§1.817–5 Diversification requirements for variable annuity, endowment, and life insurance contracts.

* * * * *

(f) * * *

(3) * * *

(iii) Held by the trustee of a qualified pension or retirement plan;

(iv) Held by a qualified tuition program as defined in section 529;

(v) Held by the trustee of a pension plan established and maintained outside of the United States, as defined in section 7701(a)(9), primarily for the benefit of individuals substantially all of whom are nonresident aliens, as defined in section 7701(b)(1)(B);

(vi) Held by an account which, pursuant to Puerto Rican law or regulation, is segregated from the general asset accounts of the life insurance company that owns the account, provided the requirements of section 817(d) and (h) are satisfied. Solely for purposes of this paragraph (f)(3)(vi), the requirement under section 817(d)(1) that the account be segregated pursuant to State law or regulation shall be disregarded; or

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 30, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2007, 72 F.R. 41651)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-72

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Mollo, Charles W.	Anaheim, CA	EA	December 1, 2004
Price, Richard A.	Novato, CA	CPA	April 29, 2005
Reyes, Ruperto D.	Placentia, CA	CPA	December 8, 2005
Schwartz, Kenneth J.	West Hills, CA	Attorney	February 28, 2006
McCarthy III, William P.	Sacramento, CA	EA	March 10, 2006
Deen, Mae T.	Salinas, CA	EA	April 16, 2006
Banks, Jean R.	Van Nuys, CA	EA	December 6, 2006
Eckstein, Matthew	Woodbury, NY	CPA	March 14, 2007
Cunningham, William	Philadelphia, PA	CPA	March 31, 2007
Ganz, Sheldon M.	Great Neck, NY	CPA	April 19, 2007
Smith, Sean M.	Kensington, MD	Enrolled Agent	April 27, 2007
Frascella, Russell B.	Pound Ridge, NY	CPA	April 27, 2007
Lamont, Alice	Atlanta, GA	CPA	May 4, 2007
Carroccio, Ronald P.	Staten Island, NY	CPA	May 15, 2007
Cohen, Ronald J.	Cornwall, NY	Attorney	June 21, 2007
Troese, Jr., Henry A.	Clarion, PA	Enrolled Agent	June 25, 2007
Jacob, Robert T.	Tucson, AZ	Enrolled Agent	June 27, 2007
Simontacchi, Joseph F.	Rockaway, NJ	CPA	July 3, 2007
Kimes, Larry W.	Irving, TX	CPA	July 6, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Caplan, Howard A.	Ocean, NJ	CPA	Indefinite from April 1, 2007
Tow, Marc R.	Newport Beach, CA	Attorney	Indefinite from April 1, 2007
Pyburn, Richard E.	Downers Grove, IL	CPA	Indefinite from April 9, 2007
Cook, Jack D.	South Haven, MI	CPA	Indefinite from April 17, 2007
Serban, Daniel E.	Roanoke, IN	Attorney	Indefinite from April 19, 2007
Wentz, Debora B.	Newton, NC	CPA	Indefinite from April 19, 2007
Ferguson, Duane F.	Upland, CA	CPA	Indefinite from May 1, 2007
Mulrey, Robert M.	Milton, MA	CPA	Indefinite from May 1, 2007
Colasuonno, Philip V.	New Rochelle, NY	CPA	Indefinite from May 23, 2007
Bankston, David A.	Land O Lakes, FL	CPA	Indefinite from June 1, 2007
Nagy, Robert J.	Charleston, SC	CPA	Indefinite from June 1, 2007
Wallen, David G.	Beckley, WV	CPA	Indefinite from June 15, 2007

Name	Address	Designation	Date of Suspension
Rudick, Josephine M.	Bear Creek, PA	Enrolled Agent	Indefinite from June 25, 2007
Iglesias, Jorge E.	Roswell, GA	CPA	Indefinite from July 1, 2007
Raimer, Russell B.	Brecksville, OH	CPA	Indefinite from July 1, 2007
Stancukas, Stanley J.	Forth Worth, TX	CPA	Indefinite from July 1, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Barach, Malcolm J.	Brookline, MA	Attorney	Indefinite from March 9, 2007
Cox, Marlisa R.	Oklahoma City, OK	CPA	Indefinite from April 2, 2007
Artis, Paris A.	Newberry, FL	Attorney	Indefinite from April 13, 2007
Blackadar, Christine M.	Center Harbor, NH	Attorney	Indefinite from April 13, 2007
Brelje, Brian J.	Laguna Beach, CA	CPA	Indefinite from April 13, 2007
Decker, Craig A.	Mesa, AZ	Attorney	Indefinite from April 13, 2007
House, Stephen M.	Nevada City, CA	CPA	Indefinite from April 13, 2007

Name	Address	Designation	Date of Suspension
Laird, James J.	San Ramon, CA	CPA	Indefinite from April 13, 2007
Milner, Dennis V.	Dublin, CA	Attorney	Indefinite from April 13, 2007
Nutt, Jeremy C.	Forth Worth, TX	Attorney	Indefinite from April 13, 2007
Picl, Frank M.	Peoria, IL	Attorney	Indefinite from April 13, 2007
Britt, Jerry U.	Mount Olive, NC	CPA	Indefinite from April 19, 2007
Lee, Janell M.	Oakland, CA	CPA	Indefinite from April 19, 2007
Baker, Sean W.	Elkridge, MD	Attorney	Indefinite from April 30, 2007
Brett, Stephen M.	York Beach, ME	Attorney	Indefinite from April 30, 2007
Donahue, Richard K.	Lowell, MA	CPA	Indefinite from April 30, 2007
Frank, Mack I.	Eunice, LA	Attorney	Indefinite from April 30, 2007
Leung, Elsie Y.	Pasadena, CA	CPA	Indefinite from April 30, 2007
Pearlman, Stephen E.	Dix Hills, NY	Attorney	Indefinite from April 30, 2007
Peer, Jameelah	Waimanalo, HI	Attorney	Indefinite from April 30, 2007
Riskowski, Patrick T.	Omaha, NE	Attorney	Indefinite from April 30, 2007
Schumacher, Mary M.	Dubuque, IA	Attorney	Indefinite from April 30, 2007

Name	Address	Designation	Date of Suspension
DeVaughn, Donald L.	Plainview, MN	Attorney	Indefinite from May 1, 2007
Waggle, Stephen L.	Los Banos, CA	CPA	Indefinite from May 24, 2007
Nefsky, Melvyn I.	Los Angeles, CA	CPA	Indefinite from June 11, 2007
Neuendorf, Louis E.	Sandwich, IL	Attorney	Indefinite from June 11, 2007
Thomas, Scott C.	Parker, CO	Attorney	Indefinite from June 11, 2007
Todd, Donald J.	South Holland, IL	CPA	Indefinite from June 11, 2007
Winrow, Wayne	Emeryville, CA	Attorney	Indefinite from June 11, 2007
Cannon, Todd R.	Florence, CO	Attorney	Indefinite from June 12, 2007
Hester, Karen H.	Overland Park, KS	Attorney	Indefinite from June 25, 2007
Denman, Dwight E.	Dallas, TX	Attorney	Indefinite from June 25, 2007
Korcan, Barry	Loretto, PA	CPA	Indefinite from June 25, 2007
Lloyd, Max C.	South Jordan, UT	CPA	Indefinite from June 25, 2007
White, Lanny R.	Lindon, UT	CPA	Indefinite from June 25, 2007
Bjorklund, Dennis A.	Coralville, IA	Attorney	Indefinite from June 28, 2007
Noel, Robert	Fairfield, CA	Attorney	Indefinite from June 28, 2007
Sanger, Susan L.	Greenwood Village, CO	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Shatzen, Robert S.	Beaverton, OR	Attorney	Indefinite from June 28, 2007
Stevenson, Albert D.	Olive Branch, MS	CPA	Indefinite from June 28, 2007
Van Beek, Andrea	Orange City, IA	Attorney	Indefinite from June 28, 2007
Sojcher, Stuart H.	Winchester, MA	Attorney	Indefinite from July 3, 2007
Estrada, Severo C.	San Jose, CA	CPA	Indefinite from July 3, 2007
Ferguson, Robert E.	Salt Point, NY	Attorney	Indefinite from July 3, 2007
Wickenkamp, Mary C.	Denison, TX	Attorney	Indefinite from July 3, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Cettomai, Joseph W.	Rootstown, OH	CPA	Indefinite from April 19, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Haynes, Scott Y.	Valdosta, GA	CPA	March 19, 2007

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Lyons, John K.	Dingmans Ferry, PA	Attorney	April 4, 2007
Bowman, T. Hardie	Corpus Christi, TX	CPA	May 23, 2007
Kofford, Brian T.	Provo, UT	CPA	June 12, 2007

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

Name	Address	Date of Resignation
Hancock, William H.	Plant City, FL	April 10, 2007

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the second half of 2007 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

Rev. Rul. 2007–55

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charge and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/07 - 12/31/07	$37.91	Up to 500 miles = $.2074 per mile
		501–1500 miles = $.1581 per mile
		Over 1500 miles = $.1520 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622–0047 (not a toll-free call).

Section 807.—Rules for Certain Reserves

(Also § 812.)

Life insurance reserves. This ruling provides guidance regarding (1) the amount of life insurance reserves taken into account for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves and (2) what interest rate is used to calculate required interest under section 812(b)(2)(A) of the Code on life insurance reserves in situations where the amount of those reserves is the tax reserve determined under section 807(d)(2).

Rev. Rul. 2007–54

ISSUE(S)

1. What is the amount of the life insurance reserves taken into account under section 807 of the Internal Revenue Code for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves?

2. If the amount of the life insurance reserves for a variable contract is the tax reserve determined under section 807(d)(2), what interest rate is used to calculate required interest on those reserves?

FACTS

Situation 1. IC is a life insurance company as defined in section 816(a) and is the issuer of Contract A. Contract A provides for the payment of variable annuity benefits computed on the basis of a recognized mortality table and the investment experience of *IC*'s segregated asset account (separate account). *IC* bears the mortality risks with regard to the contingencies involved in the variable annuity benefits. Contract A neither provides any "supplemental benefits" (as defined in section 807(e)(3)(D)) nor involves any "qualified substandard risks" (as defined in section 807(e)(5)(B)).

Contract A is a "variable contract" as defined in section 817(d) and an "annuity contract" under section 817(g). *IC*'s reserves for Contract A are "life insurance reserves" as defined in section 816(b).

For taxable years 2006 and 2007, the amounts of end-of-year tax reserves determined under section 807(d)(2) for Contract A are $8,000 and $10,000, respectively. The applicable Federal interest rate for Contract A is 4.82 percent, and the applicable Federal interest rate exceeds the prevailing State assumed rate for the Contract.

The 2006 and 2007 end-of-year net surrender values determined under section 807(e)(1) for Contract A are $7,840 and $9,830, respectively. The amounts taken into account by *IC* with regard to Contract A in determining its 2006 and 2007 end-of-year statutory reserves within the meaning of section 807(d)(6) are $8,050 and $10,045, respectively. None of *IC*'s statutory reserves is attributable to any deferred or uncollected premium.

Situation 2. The facts are the same as Situation 1, except that Contract A provides a minimum guaranteed death benefit in addition to variable annuity benefits. *IC* bears the mortality risks and investment risks with regard to the contingencies involved in the provision of the death benefit.

For taxable years 2006 and 2007, the end-of-year tax reserves determined under section 807(d)(2) for Contract A are $8,155 and $10,165, respectively. The 2006 and 2007 end-of-year net surrender values determined under section 807(e)(1) for Contract A are $8,000 and $10,000, respectively. The amount taken into account by *IC* with regard to Contract A in determining its 2006 and 2007 end-of-year statutory reserves within the meaning of section 807(d)(6) are $8,210 and $10,215, respectively.

If Contract A had not provided the minimum guaranteed death benefit, the 2006 and 2007 end-of-year tax reserves determined under section 807(d)(2) would have been $8,000 and $10,000, respectively.

LAW AND ANALYSIS

Issue 1. Section 803(a) provides that life insurance company gross income is the sum of (i) premiums, (ii) net decreases in certain reserves under section 807(a), and (iii) other amounts generally included by a taxpayer in gross income. Section 805(a)(2) authorizes a deduction for the net increase in certain reserves under section 807(b). In calculating the change in reserves for a variable contract, the increase or decrease in the reserves due to appreciation and depreciation of separate account assets is removed. *See* section 817(a).

Section 807(c) sets forth the items taken into account in determining the net decrease or net increase in reserves under section 807(a) and (b). Among the items taken into account are "life insurance reserves" (as defined in section 816(b)).

For purposes of determining a life insurance company's income or deduction from a change in reserves, section 807(d)(1) provides that the amount of the life insurance reserves for any contract is the greater of— (i) the contract's net surrender value, or (ii) the contract's tax reserve determined under section 807(d)(2). However, the life insurance reserves for a contract cannot exceed the "statutory reserves" (as defined in section 807(d)(6)).

Section 807(d)(2) provides that the amount of the tax reserve for any contract is determined using— (i) the tax reserve method applicable to the contract, (ii) the greater of the applicable Federal interest rate or the prevailing State assumed interest rate, and (iii) the prevailing commissioners' standard tables for mortality and morbidity adjusted as appropriate to reflect the risks (such as substandard risks) incurred under the contract which are not otherwise taken into account. The tax reserves determined under section 807(d)(2) reflect all of the benefits (including the net surrender value) payable under the contract.

Section 807(e)(1) provides generally that the net surrender value of "any contract" is determined with regard to any penalty or charge which would be imposed on surrender, but without regard to any market value adjustment on surrender. The net surrender value represents the current contractual cash benefit payable under a contract.

Except as otherwise provided in special rules under section 807(e)(3) and (5) (relating to qualified supplemental benefits and qualified substandard risks), the comparison of the tax reserve and the net surrender value is made on an aggregate benefit basis. *See* H. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess. 1414 (1984); S. Prt. 169, Vol. I, 98th Cong. 2d Sess. 540 (1984).

Section 807 makes no distinction between a fixed (non-variable) contract and a variable contract. For both fixed and variable contracts, a life insurance company determines its income or deduction from a change in reserves using the amounts of its life insurance reserves determined under section 807. *See also* section 817(a) (referring to "the sum of the items described in section 807(c)").

Section 817(c) requires a life insurance company to account separately for the income, exclusion, deduction, asset, reserve, and other liability items attributable to variable contracts. If a variable contract contains a guarantee (for example, a minimum death benefit), section 817(d) (flush language) requires an insurance company to account for the excess of obligations under the guarantee over the obligations under the contract without regard to the guarantee as part of the company's general account, and not as part of the company's separate account.

In both Situation 1 and Situation 2, the end-of-year tax reserves determined under section 807(d)(2) for Contract A— (i) exceed the end-of-year net surrender value of the Contract, but (ii) are less than the end-of-year statutory reserves for the Contract. Accordingly, under section 807(d)(1), the amount of the end-of-year life insurance reserves taken into account under section 807 for Contract A in both Situations is the amount of the end-of-year tax reserves determined under section 807(d)(2). In Situation 1, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,000 and $10,000, respectively. In Situation 2, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,155 and $10,165, respectively.

In Situation 2, *IC* is required under section 817(d) to account for the excess of its obligations under Contract A with the minimum death benefit over its obligations under the Contract without the death benefit as part of the company's general account reserves. Pursuant to section 817(c), *IC* accounts for its remaining obligations under the Contract A as part of the company's separate account reserves. Accordingly, for end-of-year 2006, *IC* accounts for the $155 excess of its obligations under Contract A with the minimum death benefit ($8,155) over its obligations under the Contract without the death benefit ($8,000) as part of the company's general account reserves. *IC* accounts for the remaining $8,000 as part of its separate account reserves. For end-of-year 2007, *IC* accounts for the $165 excess of its obligations under Contract A with the minimum death benefit ($10,165) over its obligations under Contract A without the death benefit ($10,000) as part of the company's general account reserves. *IC* accounts for the remaining $10,000 as part of its separate account reserves.

The allocation of obligations between general account reserves and separate account reserves has no effect on the determination of the amount of *IC*'s life insurance reserves for Contract A under section 807(d).

Issue 2. To prevent a life insurance company from realizing a double benefit for tax-preferred investment income (tax-exempt interest and dividends qualifying

for the dividends received deduction) used to fund the company's obligations to policyholders, sections 807 and 805 require the company to adjust certain income and deduction items for the policyholders' share of such tax preferred income. *See* section 807(a) and (b), section 805(a)(4).

Section 812 provides the mechanism to calculate the life insurance company's and policyholders' respective shares of net investment income. Under section 812(b)(1), a life insurance company's share of net investment income is the excess (if any) of "net investment income" (determined under section 812(c)) for the taxable year over the sum of (i) "policy interest" (determined under section 812(b)(2)) for the taxable year, and (ii) the "gross investment income's proportionate share of policyholder dividends" (determined under section 812(b)(3)) for the taxable year.

Policy interest includes "required interest" on reserves. Section 812(b)(2)(A). Required interest on a contract's reserves is calculated using the mean of the contract's beginning-of-year and end-of-year reserves and the interest rate used in determining the contract's reserves. For example, if the life insurance reserves for a contract are determined using the greater of the applicable Federal interest rate or the prevailing State assumed interest rate for the contract, then required interest on those reserves is calculated by multiplying (i) the mean of the reserves by (ii) the interest rate used in calculating the reserves (*i.e.*, the greater of the applicable Federal interest rate or the prevailing State assumed interest rate for the contract). If neither the prevailing State assumed interest rate nor the applicable Federal interest rate is used in determining a contract's life insurance reserves, then required interest is calculated using another appropriate rate. Section 812(b)(2); Rev. Rul. 2003–120, 2003–2 C.B. 1154.

In both Situation 1 and Situation 2, the amount of the life insurance reserves taken into account under section 807 for Contract A is the amount of tax reserve determined under section 807(d)(2), which is determined using the applicable Federal interest rate for the Contract. As the applicable Federal interest rate is used to determine the amount of the life insurance reserves for Contract A, the required interest on the Contract's life insurance reserves is calculated by multiplying the mean of those reserves by the applicable Federal interest rate for the Contract. Rev. Rul. 2003–120.

In Situation 1, the mean of the 2007 beginning-of-year and end-of-year life insurance reserves for Contract A is $9,000 ([$8,000 + $10,000] ÷ 2 = $9,000) and the applicable Federal interest rate for Contract A is 4.82 percent. For taxable year 2007, the required interest on Contract A's life insurance reserves is $433.80 ($9,000 × 4.82% = $433.80).

In Situation 2, the mean of the 2007 beginning-of-year and end-of-year life insurance reserves for Contract A is $9,160 ([$8,155 + $10,165] ÷ 2 = $9,160). The applicable Federal interest rate for Contract A is 4.82 percent. For taxable year 2007, the required interest on Contract A's life insurance reserves is $441.51 ($9,160 × 4.82% = $441.51). Consistent with the allocation of Contract A's life insurance reserves between *IC*'s general account reserves and separate account reserves, $7.71 of the required interest ($441.51 × $160 / $9,160 = $7.71) is taken into account under section 812 as required interest on *IC*'s general account reserves. The remaining $433.80 ($441.51 × $9,000 / $9,160 = $433.80) of the required interest is taken into account under section 812 as required interest on *IC*'s separate account reserves.

HOLDING(S)

1. Under section 807(d)(1), the amounts of the end-of-year life insurance reserves for Contract A in both Situation 1 and Situation 2 are the amounts of the tax reserve determined under section 807(d)(2). Thus, in Situation 1, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,000 and $10,000, respectively. In Situation 2, the amounts of the 2006 and 2007 end-of-year life insurance reserves for Contract A are $8,155 and $10,165, respectively.

2. In both Situation 1 and Situation 2, the required interest on Contract A's life insurance reserves is calculated by multiplying the mean of the Contract's beginning-of-year and end-of-year reserves by the applicable Federal interest rate for the Contract. In Situation 1, the 2007 required interest on Contract A's life insurance reserves is $433.80. In Situation 2, the 2007 required interest on Contract A's life insurance reserves is $441.51. Of this amount, $7.71 is required interest on *IC*'s general account reserves for Contract A, and the remaining $433.80 is required interest on *IC*'s separate account reserves for Contract A.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stephen D. Hooe of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Stephen D. Hooe at (202) 622–3900 (not a toll-free call).

Section 812.—Definition of Company's Share and Policyholders' Share

A revenue ruling that provides guidance regarding (1) the amount of life insurance reserves taken into account for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves and (2) what interest rate is used to calculate required interest under section 812(b)(2)(A) on life insurance reserves in situations where the amount of those reserves is the tax reserve determined under section 807(d)(2). See Rev. Rul. 2007-54, page 604.

Section 893.—Compensation of Employees of Foreign Governments or International Organizations

26 CFR 1.893–1: Compensation of employees of foreign governments or international organizations.

Revenue rulings obsolete. This ruling obsoletes Rev. Rul. 75–425, 1975–2 C.B. 291, which provides guidance related to the effect of signing a waiver (USCIS Form I–508) under section 247(b) of the Immigration and Nationality Act (8 U.S.C. section 1257(b)) by alien individuals employed in the United States by a foreign government or international organization. Rev. Rul. 75–425 obsoleted.

Rev. Rul. 2007–60

The Internal Revenue Service is continuing its program of reviewing guidance (including revenue rulings, revenue procedures, and notices) published in the In-

ternal Revenue Bulletin to identify those rulings that are obsolete because (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or subsequent published position; or (3) the facts on which the ruling position is based no longer exist or are not sufficiently described to permit clear application of the current statute and regulations.

Rev. Rul. 75–425, 1975–2 C.B. 291, concerns the effect of an alien individual employed by a foreign government or international organization in the United States signing a waiver (United States Citizenship and Immigration Services (USCIS) Form I–508) under section 247(b) of the Immigration and Nationality Act (8 U.S.C. § 1257(b)). Generally, an alien individual employed by a foreign government or international organization who files the waiver provided by section 247(b) of the Immigration and Nationality Act is, from the date of filing the waiver, no longer entitled to exemption from income tax under section 893 of the Internal Revenue Code with respect to his or her compensation received from such foreign government or international organization. *See* Treas. Reg. § 1.893–1(a)(5) and (b)(4). However, the filing of the waiver will have no effect on any income tax exemption derived by an alien individual from the provisions of an income tax treaty, consular agreement, or other international agreement to the extent the application of the exemption is not dependent upon the internal revenue laws of the United States. *See* Treas. Reg. § 1.893–1(c)(2).

Rev. Rul. 75–425 sets forth the application of the above rules with respect to a list of foreign countries with which the United States had an income tax treaty or consular agreement and a list of international organizations with respect to which the United States was a signatory to the international agreement creating the international organization(s) at the time of publication of the revenue ruling. Because many of those income tax treaties, consular agreements, and international agreements have been modified, superseded, or are no longer in force, and because the facts on which the ruling position was based no longer exist or are not sufficiently described to permit clear application of the currently applicable legal provisions and agreements, the Internal Revenue Service has concluded that Rev. Rul. 75–425 is no longer determinative with respect to foreign government and international organization employees of any foreign country. Accordingly, Rev. Rul. 75–425 is hereby declared obsolete.

Alien individuals employed by a foreign government or international organization in the United States, who file the waiver provided by section 247(b) of the Immigration and Nationality Act (USCIS Form I–508), will be entitled to any tax exemption conferred under the provisions of an applicable income tax treaty, consular agreement, or international agreement, that is still in force, to the extent the application of the exemption is not dependent upon the internal revenue laws of the United States. For guidance with respect to a specific foreign country or international organization, send an e-mail to *embassy@irs.gov*.

DRAFTING INFORMATION

Various personnel from the Office of Associate Chief Counsel (International) participated in the drafting of this revenue ruling. For further information regarding this revenue ruling, contact Richard A. Ward at (202) 874–1621 (not a toll-free call) or e-mail *embassy@irs.gov*.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011–4: Requirement of statement disclosing participation in certain transactions by taxpayers.

T.D. 9350

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 20, 25, 31, 53, 54, and 56

AJCA Modifications to the Section 6011 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6011 of the Internal Revenue Code that modify the rules relating to the disclosure of reportable transactions under section 6011. These regulations affect taxpayers participating in reportable transactions under section 6011, material advisors responsible for disclosing reportable transactions under section 6111, and material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend 26 CFR part 1 by modifying and clarifying the rules relating to the disclosure of reportable transactions under section 6011. This document also contains final regulations that amend 26 CFR parts 20, 25, 31, 53, 54, and 56 by modifying the rules for purposes of estate, gift, employment, and pension and exempt organizations excise taxes that require the disclosure of listed transactions by certain taxpayers on their Federal tax returns under section 6011.

The American Jobs Creation Act of 2004, Public Law 108–357, (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. The AJCA revised sections 6111 and 6112, thereby necessitating changes to the rules under section 6011. On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and the comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on the recommendations made in the public comments.

Summary of Comments and Explanation of Provisions

Nine written comments were received in response to the NPRM. All comments were considered and are available for public inspection upon request.

Transactions of Interest

The proposed regulations identified transactions of interest as a new reportable transaction category. As stated in the preamble to the proposed regulations, a transaction of interest is a transaction that the IRS and Treasury Department believe has a potential for tax avoidance or evasion, but for which the IRS and Treasury Department lack enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction. These final regulations adopt the language in the proposed regulations regarding transactions of interest without modification. This language provides that a transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest. These final regulations also retain the language in the proposed regulations that provide that a taxpayer's participation in a transaction of interest will be determined in the published guidance which identifies the transaction of interest.

Several commentators requested more specificity and guidance on the definition of what constitutes a transaction of interest. Specifically, the commentators recommended that the term "participation," for purposes of determining whether a taxpayer participated in a transaction of interest, be defined in the regulations rather than in the published guidance identifying the transaction of interest. The commentators also requested that the published guidance describing a transaction of interest be crafted in a clear and specific manner, thereby enabling taxpayers to determine whether they participated in a transaction of interest. One commentator also recommended providing a list of factors in the regulations that the IRS would consider when identifying a transaction of interest. Further, several commentators requested that the IRS and Treasury Department provide notice to taxpayers that the IRS and Treasury Department are considering designating a particular transaction as a transaction of interest and requesting comments prior to publishing guidance identifying a transaction as a transaction of interest.

The IRS and Treasury Department believe that providing a specific definition for the transactions of interest category in the regulations would unduly limit the IRS and Treasury Department's ability to identify transactions that have the potential for tax avoidance or evasion. In order to maintain flexibility in identifying a transaction of interest, the description of a transaction of interest will be provided in the published guidance that identifies the transaction of interest. The published guidance identifying a transaction of interest will provide taxpayers with the information necessary to determine whether a particular transaction is the same as or substantially similar to the transaction described in the published guidance and to determine who participated in the transaction.

The IRS and Treasury Department do not believe that the regulations should be amended to include language requiring the IRS and Treasury Department to provide advance notice for transactions of interest as suggested by the commentators. However, the IRS and Treasury Department may choose to publish advance notice and request comments in certain circumstances. The determination of whether to provide advance notice and a request for comments will be made on a transaction by transaction basis.

The proposed regulations also provide that upon publication of the final regulations, the transactions of interest category of reportable transaction will apply to transactions entered into on or after November 2, 2006. These final regulations adopt the effective date stated in the proposed regulations.

The preamble to the proposed regulations provides that when the IRS and Treasury Department have gathered enough information to make an informed decision as to whether a particular transaction of interest is a tax avoidance type of transaction, the IRS and Treasury Department may take one or more actions, including removing the transaction from the transaction of interest category in published guidance, designating the transaction as a listed transaction, or providing a new category of reportable transaction. Several commentators recommended that the period during which a transaction may be considered a transaction of interest be limited to twenty-four months, unless the IRS and Treasury Department affirmatively act to extend the designation for an additional twenty-four months with no limit on the number of permissible extensions. One commentator suggested that the length of the period be limited to twenty-four months, with no extensions.

The IRS and Treasury Department believe that limiting the length of time a transaction may be designated a transaction of interest would be contrary to the purpose of the transactions of interest category of reportable transaction and would hinder the ability of the IRS and Treasury Department to efficiently and effectively gather the necessary information to determine whether a particular transaction is a tax avoidance type of transaction. Accordingly, these final regulations do not adopt these suggestions.

Disclosure of Reportable Transactions by Owners of a Pass-through Entity

I. *Timing of disclosures*

The proposed regulations provide that if a taxpayer who is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust receives a timely Schedule K–1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K–1, the taxpayer determines that the taxpayer participated in a reportable transaction, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement

with the Office of Tax Shelter Analysis (OTSA) within 45 calendar days after the due date of the taxpayer's return (including extensions). Several commentators requested that the proposed regulations not limit relief to taxpayers who receive a timely Schedule K–1 before the due date of their return. Others believed the 45 day disclosure period was too short. One commentator recommended that the provision apply to late disclosures that were inadvertent or non-abusive. One commentator recommended that the 10 day period be extended to 30 days and the 45 day disclosure period be extended to 90 days. With respect to the date the disclosure period begins, two commentators commented that the disclosure period should begin on the date the taxpayer receives the timely Schedule K–1.

The IRS and Treasury Department agree that the 45 day disclosure period should be extended. These final regulations extend the disclosure period to 60 calendar days. The IRS and Treasury Department believe that this additional period will provide taxpayers with ample time to review the entity's return and comply with any administrative and regulatory requirements before filing their disclosure statement. It should be noted that if a taxpayer receives a timely Schedule K–1 after the due date of the taxpayer's return (including extensions), the taxpayer will have received the timely Schedule K–1 less than 10 calendar days before the due date of the return and will have 60 calendar days after the due date of the taxpayer's return (including extensions) to file the disclosure statement.

II. *Pass-through owners*

Several commentators have suggested that the disclosure obligations of owners of a pass-through entity that participates in a reportable transaction be amended to provide that only certain owners of the pass-through entity are required to disclose their participation in the reportable transaction. One commentator suggested that an owner of a pass-through entity should be removed from this disclosure obligation when (1) the owner did not know and should not have known that the pass-through entity engaged in the reportable transaction; and (2) the pass-through entity failed to disclose timely its participation in the reportable transaction on its return to OTSA. The commentator also recommends that if the owner knew or reasonably should have known of the pass-through entity's participation in the reportable transaction, the owner should be required to file a disclosure statement even if the pass-through entity did not disclose the transaction to the owner. A different commentator suggested that an owner of a pass-through entity not be required to disclose the owner's participation in a reportable transaction, even if the owner knew or should have known of the pass-through entity's participation in the reportable transaction.

Several commentators also suggested adopting a *de minimis* ownership rule exempting taxpayers owning less than a certain percentage of the pass-through entity from the disclosure requirements. One commentator suggested exempting owners of 5 percent or less of the outstanding interests in the pass-through entity that participates in a reportable transaction.

The IRS and Treasury Department are aware that certain partners, shareholders, and beneficiaries may file income tax returns that reflect the tax consequences, tax benefits, or tax strategy of a reportable transaction even though the taxpayer is unaware that the pass-through entity engaged in the reportable transaction. The IRS and Treasury Department recognize the concerns of the commentators. In light of the potential monetary penalties for failing to disclose participation in a reportable transaction and in order to maintain flexibility in determining who should be subject to the disclosure requirements for a particular transaction, these final regulations amend the proposed regulations to add language providing flexibility to the IRS and Treasury Department to issue other provisions for disclosure under §1.6011–4 in published guidance.

Time Period for Disclosing Participation in a Listed Transaction and Transaction of Interest

Under the proposed regulations if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the listed transaction or transaction of interest in the year the transaction became a listed transaction or a transaction of interest, with OTSA within 60 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. The proposed regulations also provide that the Commissioner may determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

Many commentators suggested that the current rule, which requires the disclosure of subsequently identified listed transactions on the taxpayer's next filed tax return be retained in light of the potential monetary penalties and potential administrative burden due to the shortened disclosure period. One commentator recommended that the taxpayer be required to file the disclosure statement by the later of the taxpayer's next filed tax return or within 60 calendar days after the date on which the transaction becomes a listed transaction or transaction of interest.

A critical factor in the ability to analyze a particular transaction is the ability to have the necessary information available in a timely manner. Thus, requiring taxpayers to file a disclosure statement with OTSA in a timely manner is essential. Because the IRS and Treasury Department recognize that compliance within 60 calendar days may be burdensome in certain circumstances, the proposed regulations are amended to provide that taxpayers have 90 calendar days to disclose their participation in a subsequently identified listed transaction or transaction of interest.

Brief Asset Holding Period Reportable Transaction Category

Due to changes in section 901 and based on comments received, the IRS and Treasury Department have determined that the brief asset holding period reportable transaction category is no longer necessary. These final regulations therefore remove this category as a reportable transaction category.

Form 8271

Before the enactment of the AJCA, section 6111 provided that tax shelter organizers were required to provide investors in tax shelters the registration number for the tax shelter. Section 301.6111–1T, Q&A 55, requires investors to report the registration number of the tax shelter to the IRS on Form 8271, "*Investor Reporting of Tax Shelter Registration Number*", and attach the Form 8271 to any return on which any deduction, loss, credit, or other tax benefit attributable to the tax shelter is claimed. Because only a few investors must still file Form 8271 for pre-AJCA section 6111 tax shelters and because the IRS already is aware of these transactions, the IRS and Treasury Department have decided that investors are no longer required to file Forms 8271 otherwise due on or after August 3, 2007. The Form 8271 will be obsoleted. Taxpayers required to file Form 8886, "*Reportable Transaction Disclosure Statement*", pursuant to §1.6011–4(d), and Form 8271 with respect to the same transaction only need to report the registration number on Form 8886.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 35) do not apply. The disclosure statement referenced in these regulations has been made available for public comment and any update to the disclosure statement will be made available for public comment in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35). Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, 31, 53, 54, and 56 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6011–4 is revised to read as follows:

§1.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* Every taxpayer that has participated, as described in paragraph (c)(3) of this section, in a reportable transaction within the meaning of paragraph (b) of this section and who is required to file a tax return must file within the time prescribed in paragraph (e) of this section a disclosure statement in the form prescribed by paragraph (d) of this section. The fact that a transaction is a reportable transaction shall not affect the legal determination of whether the taxpayer's treatment of the transaction is proper.

(b) *Reportable transactions*—(1) *In general.* A reportable transaction is a transaction described in any of the paragraphs (b)(2) through (7) of this section. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan.

(2) *Listed transactions.* A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.

(3) *Confidential transactions*—(i) *In general.* A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.

(ii) *Conditions of confidentiality.* A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

(iii) *Minimum fee.* For purposes of this paragraph (b)(3), the minimum fee is—

(A) $250,000 for a transaction if the taxpayer is a corporation;

(B) $50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is $250,000.

(iv) *Determination of minimum fee.* For purposes of this paragraph (b)(3), in determining the minimum fee, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of the facts and circumstances. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee

or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a confidential transaction constitutes fees.

(v) *Related parties.* For purposes of this paragraph (b)(3), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

(4) *Transactions with contractual protection*—(i) *In general.* A transaction with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(ii) *Fees.* Paragraph (b)(4)(i) of this section only applies with respect to fees paid by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction.

(iii) *Exceptions*—(A) *Termination of transaction.* A transaction is not considered to have contractual protection solely because a party to the transaction has the right to terminate the transaction upon the happening of an event affecting the taxation of one or more parties to the transaction.

(B) *Previously reported transaction.* If a person makes or provides a statement to a taxpayer as to the potential tax consequences that may result from a transaction only after the taxpayer has entered into the transaction and reported the consequences of the transaction on a filed tax return, and the person has not previously received fees from the taxpayer relating to the transaction, then any refundable or contingent fees are not taken into account in determining whether the transaction has contractual protection. This paragraph (b)(4) does not provide any substantive rules regarding when a person may charge refundable or contingent fees with respect to a transaction. See Circular 230, 31 CFR Part 10, for the regulations governing practice before the IRS.

(5) *Loss transactions*—(i) *In general.* A loss transaction is any transaction resulting in the taxpayer claiming a loss under section 165 of at least—

(A) $10 million in any single taxable year or $20 million in any combination of taxable years for corporations;

(B) $10 million in any single taxable year or $20 million in any combination of taxable years for partnerships that have only corporations as partners (looking through any partners that are themselves partnerships), whether or not any losses flow through to one or more partners; or

(C) $2 million in any single taxable year or $4 million in any combination of taxable years for all other partnerships, whether or not any losses flow through to one or more partners;

(D) $2 million in any single taxable year or $4 million in any combination of taxable years for individuals, S corporations, or trusts, whether or not any losses flow through to one or more shareholders or beneficiaries; or

(E) $50,000 in any single taxable year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership, if the loss arises with respect to a section 988 transaction (as defined in section 988(c)(1) relating to foreign currency transactions).

(ii) *Cumulative losses.* In determining whether a transaction results in a taxpayer claiming a loss that meets the threshold amounts over a combination of taxable years as described in paragraph (b)(5)(i) of this section, only losses claimed in the taxable year that the transaction is entered into and the five succeeding taxable years are combined.

(iii) *Section 165 loss*—(A) For purposes of this section, in determining the thresholds in paragraph (b)(5)(i) of this section, the amount of a section 165 loss is adjusted for any salvage value and for any insurance or other compensation received. See §1.165–1(c)(4). However, a section 165 loss does not take into account offsetting gains, or other income or limitations. For example, a section 165 loss does not take into account the limitation in section 165(d) (relating to wagering losses) or the limitations in sections 165(f), 1211, and 1212 (relating to capital losses). The full amount of a section 165 loss is taken into account for the year in which the loss is sustained, regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or a net capital loss under section 1212 that is a carryback or carryover to another year. A section 165 loss does not include any portion of a loss, attributable to a capital loss carryback or carryover from another year, that is treated as a deemed capital loss under section 1212.

(B) For purposes of this section, a section 165 loss includes an amount deductible pursuant to a provision that treats a transaction as a sale or other disposition, or otherwise results in a deduction under section 165. A section 165 loss includes, for example, a loss resulting from a sale or exchange of a partnership interest under section 741 and a loss resulting from a section 988 transaction.

(6) *Transactions of interest.* A transaction of interest is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest.

(7) [*Reserved*].

(8) *Exceptions*—(i) *In general.* A transaction will not be considered a reportable transaction, or will be excluded from any individual category of reportable transaction under paragraphs (b)(3) through (7) of this section, if the Commissioner makes a determination by published guidance that the transaction is not subject to the reporting requirements of this section. The Commissioner may make a determination by individual letter ruling under paragraph (f) of this section that an individual letter rul-

ing request on a specific transaction satisfies the reporting requirements of this section with regard to that transaction for the taxpayer who requests the individual letter ruling.

(ii) *Special rule for RICs.* For purposes of this section, a regulated investment company (RIC) as defined in section 851 or an investment vehicle that is owned 95 percent or more by one or more RICs at all times during the course of the transaction is not required to disclose a transaction that is described in any of paragraphs (b)(3) through (5) and (b)(7) of this section unless the transaction is also a listed transaction or a transaction of interest.

(c) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Taxpayer.* The term *taxpayer* means any person described in section 7701(a)(1), including S corporations. Except as otherwise specifically provided in this section, the term *taxpayer* also includes an affiliated group of corporations that joins in the filing of a consolidated return under section 1501.

(2) *Corporation.* When used specifically in this section, the term *corporation* means an entity that is required to file a return for a taxable year on any 1120 series form, or successor form, excluding S corporations.

(3) *Participation*—(i) *In general*—(A) *Listed transactions.* A taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction under paragraph (b)(2) of this section. A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction under paragraph (b)(2) of this section. Published guidance may identify other types or classes of persons that will be treated as participants in a listed transaction. Published guidance also may identify types or classes of persons that will not be treated as participants in a listed transaction.

(B) *Confidential transactions.* A taxpayer has participated in a confidential transaction if the taxpayer's tax return reflects a tax benefit from the transaction and the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in paragraph (b)(3) of this section. If a partnership's, S corporation's or trust's disclosure is limited, and the partner's, shareholder's, or beneficiary's disclosure is not limited, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the confidential transaction.

(C) *Transactions with contractual protection.* A taxpayer has participated in a transaction with contractual protection if the taxpayer's tax return reflects a tax benefit from the transaction and, as described in paragraph (b)(4) of this section, the taxpayer has the right to the full or partial refund of fees or the fees are contingent. If a partnership, S corporation, or trust has the right to a full or partial refund of fees or has a contingent fee arrangement, and the partner, shareholder, or beneficiary does not individually have the right to the refund of fees or a contingent fee arrangement, then the partnership, S corporation, or trust, and not the partner, shareholder, or beneficiary, has participated in the transaction with contractual protection.

(D) *Loss transactions.* A taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss equals or exceeds the threshold amount applicable to the taxpayer as described in paragraph (b)(5)(i) of this section. If a taxpayer is a partner in a partnership, shareholder in an S corporation, or beneficiary of a trust and a section 165 loss as described in paragraph (b)(5) of this section flows through the entity to the taxpayer (disregarding netting at the entity level), the taxpayer has participated in a loss transaction if the taxpayer's tax return reflects a section 165 loss and the amount of the section 165 loss that flows through to the taxpayer equals or exceeds the threshold amounts applicable to the taxpayer as described in paragraph (b)(5)(i) of this section. For this purpose, a tax return is deemed to reflect the full amount of a section 165 loss described in paragraph (b)(5) of this section allocable to the taxpayer under this paragraph (c)(3)(i)(D), regardless of whether all or part of the loss enters into the computation of a net operating loss under section 172 or net capital loss under section 1212 that the taxpayer may carry back or carry over to another year.

(E) *Transactions of interest.* A taxpayer has participated in a transaction of interest if the taxpayer is one of the types or classes of persons identified as participants in the transaction in the published guidance describing the transaction of interest.

(F) [*Reserved*].

(G) *Shareholders of foreign corporations*—*(1) In general.* A reporting shareholder of a foreign corporation participates in a transaction described in paragraphs (b)(2) through (5) and (b)(7) of this section if the foreign corporation would be considered to participate in the transaction under the rules of this paragraph (c)(3) if it were a domestic corporation filing a tax return that reflects the items from the transaction. A reporting shareholder of a foreign corporation participates in a transaction described in paragraph (b)(6) of this section only if the published guidance identifying the transaction includes the reporting shareholder among the types or classes of persons identified as participants. A reporting shareholder (and any successor in interest) is considered to participate in a transaction under this paragraph (c)(3)(i)(G) only for its first taxable year with or within which ends the first taxable year of the foreign corporation in which the foreign corporation participates in the transaction, and for the reporting shareholder's five succeeding taxable years.

(2) Reporting shareholder. The term *reporting shareholder* means a United States shareholder (as defined in section 951(b)) in a controlled foreign corporation (as defined in section 957) or a 10 percent shareholder (by vote or value) of a qualified electing fund (as defined in section 1295).

(ii) *Examples.* The following examples illustrate the provisions of paragraph (c)(3)(i) of this section:

Example 1. Notice 2003–55, 2003–2 C.B. 395, which modified and superseded Notice 95–53, 1995–2 C.B. 334 (see §601.601(d)(2) of this chapter), describes a lease stripping transaction in which one party (the transferor) assigns the right to receive future payments under a lease of tangible property and treats the amount realized from the assignment as its current income. The transferor later transfers the property subject to the lease in a transaction intended to qualify as a transferred basis transaction, for example, a transaction described in section 351. The transferee corporation claims the deductions associated with the high basis property subject to the

lease. The transferor's and transferee corporation's tax returns reflect tax positions described in Notice 2003–55. Therefore, the transferor and transferee corporation have participated in the listed transaction. In the section 351 transaction, the transferor will have received stock with low value and high basis from the transferee corporation. If the transferor subsequently transfers the high basis/low value stock to a taxpayer in another transaction intended to qualify as a transferred basis transaction and the taxpayer uses the stock to generate a loss, and if the taxpayer knows or has reason to know that the tax loss claimed was derived indirectly from the lease stripping transaction, then the taxpayer has participated in the listed transaction. Accordingly, the taxpayer must disclose the transaction and the manner of the taxpayer's participation in the transaction under the rules of this section. For purposes of this example, if a bank lends money to the transferor, transferee corporation, or taxpayer for use in their transactions, the bank has not participated in the listed transaction because the bank's tax return does not reflect tax consequences or a tax strategy described in the listing notice (nor does the bank's tax return reflect a tax benefit derived from tax consequences or a tax strategy described in the listing notice) nor is the bank described as a participant in the listing notice.

Example 2. XYZ is a limited liability company treated as a partnership for tax purposes. X, Y, and Z are members of XYZ. X is an individual, Y is an S corporation, and Z is a partnership. XYZ enters into a confidential transaction under paragraph (b)(3) of this section. XYZ and X are bound by the confidentiality agreement, but Y and Z are not bound by the agreement. As a result of the transaction, XYZ, X, Y, and Z all reflect a tax benefit on their tax returns. Because XYZ's and X's disclosure of the tax treatment and tax structure are limited in the manner described in paragraph (b)(3) of this section and their tax returns reflect a tax benefit from the transaction, both XYZ and X have participated in the confidential transaction. Neither Y nor Z has participated in the confidential transaction because they are not subject to the confidentiality agreement.

Example 3. P, a corporation, has an 80% partnership interest in PS, and S, an individual, has a 20% partnership interest in PS. P, S, and PS are calendar year taxpayers. In 2006, PS enters into a transaction and incurs a section 165 loss (that does not meet any of the exceptions to a section 165 loss identified in published guidance) of $12 million and offsetting gain of $3 million. On PS' 2006 tax return, PS includes the section 165 loss and the corresponding gain. PS must disclose the transaction under this section because PS' section 165 loss of $12 million is equal to or greater than $2 million. P is allocated $9.6 million of the section 165 loss and $2.4 million of the offsetting gain. P does not have to disclose the transaction under this section because P's section 165 loss of $9.6 million is not equal to or greater than $10 million. S is allocated $2.4 million of the section 165 loss and $600,000 of the offsetting gain. S must disclose the transaction under this section because S's section 165 loss of $2.4 million is equal to or greater than $2 million.

(4) *Substantially similar*. The term *substantially similar* includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term *substantially similar* must be broadly construed in favor of disclosure. For example, a transaction may be substantially similar to a listed transaction even though it involves different entities or uses different Internal Revenue Code provisions. (See for example, Notice 2003–54, 2003–2 C.B. 363, describing a transaction substantially similar to the transactions in Notice 2002–50, 2002–2 C.B. 98, and Notice 2002–65, 2002–2 C.B. 690.) The following examples illustrate situations where a transaction is the same as or substantially similar to a listed transaction under paragraph (b)(2) of this section. (Such transactions may also be reportable transactions under paragraphs (b)(3) through (7) of this section.) See §601.601(d)(2)(ii)(*b*) of this chapter. The following examples illustrate the provisions of this paragraph (c)(4):

Example 1. Notice 2000–44, 2000–2 C.B. 255 (see §601.601(d)(2)(ii)(*b*) of this chapter), sets forth a listed transaction involving offsetting options transferred to a partnership where the taxpayer claims basis in the partnership for the cost of the purchased options but does not adjust basis under section 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the options. Transactions using short sales, futures, derivatives or any other type of offsetting obligations to inflate basis in a partnership interest would be the same as or substantially similar to the transaction described in Notice 2000–44. Moreover, use of the inflated basis in the partnership interest to diminish gain that would otherwise be recognized on the transfer of a partnership asset would also be the same as or substantially similar to the transaction described in Notice 2000–44. See §601.601(d)(2)(ii)(b).

Example 2. Notice 2001–16, 2001–1 C.B. 730 (see §601.601(d)(2)(ii)(*b*) of this chapter), sets forth a listed transaction involving a seller (X) who desires to sell stock of a corporation (T), an intermediary corporation (M), and a buyer (Y) who desires to purchase the assets (and not the stock) of T. M agrees to facilitate the sale to prevent the recognition of the gain that T would otherwise report. Notice 2001–16 describes M as a member of a consolidated group that has a loss within the group or as a party not subject to tax. Transactions utilizing different intermediaries to prevent the recognition of gain would be the same as or substantially similar to the transaction described in Notice 2001–16. An example is a transaction in which M is a corporation that does not file a consolidated return but which buys T stock, liquidates T, sells assets of T to Y, and offsets the gain on the sale of those assets with currently generated losses. See §601.601(d)(2)(ii)(*b*).

(5) *Tax*. The term *tax* means Federal income tax.

(6) *Tax benefit*. A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

(7) *Tax return*. The term *tax return* means a Federal income tax return and a Federal information return.

(8) *Tax treatment*. The tax treatment of a transaction is the purported or claimed Federal income tax treatment of the transaction.

(9) *Tax structure*. The tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed Federal income tax treatment of the transaction.

(d) *Form and content of disclosure statement*. A taxpayer required to file a disclosure statement under this section must file a completed Form 8886, "*Reportable Transaction Disclosure Statement*" (or a successor form), in accordance with this paragraph (d) and the instructions to the form. The Form 8886 (or a successor form) is the disclosure statement required under this section. The form must be attached to the appropriate tax return(s) as provided in paragraph (e) of this section. If a copy of a disclosure statement is required to be sent to the Office of Tax Shelter Analysis (OTSA) under paragraph (e) of this section, it must be sent in accordance with the instructions to the form. To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection (as defined in §301.6111–3(c)(12) of this chapter) with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of all parties involved in the transaction. An incomplete Form 8886 (or a successor form) containing a statement that information

will be provided upon request is not considered a complete disclosure statement. If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of this section. If a taxpayer receives one or more reportable transaction numbers for a reportable transaction, the taxpayer must include the reportable transaction number(s) on the Form 8886 (or a successor form). See §301.6111–3(d)(2) of this chapter.

(e) *Time of providing disclosure*—(1) *In general.* The disclosure statement for a reportable transaction must be attached to the taxpayer's tax return for each taxable year for which a taxpayer participates in a reportable transaction. In addition, a disclosure statement for a reportable transaction must be attached to each amended return that reflects a taxpayer's participation in a reportable transaction. A copy of the disclosure statement must be sent to OTSA at the same time that any disclosure statement is first filed by the taxpayer pertaining to a particular reportable transaction. If a reportable transaction results in a loss which is carried back to a prior year, the disclosure statement for the reportable transaction must be attached to the taxpayer's application for tentative refund or amended tax return for that prior year. In the case of a taxpayer that is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust, the disclosure statement for a reportable transaction must be attached to the partnership, S corporation, or trust's tax return for each taxable year in which the partnership, S corporation, or trust participates in the transaction under the rules of paragraph (c)(3)(i) of this section. If a taxpayer who is a partner in a partnership, a shareholder in an S corporation, or a beneficiary of a trust receives a timely Schedule K–1 less than 10 calendar days before the due date of the taxpayer's return (including extensions) and, based on receipt of the timely Schedule K–1, the taxpayer determines that the taxpayer participated in a reportable transaction within the meaning of paragraph (c)(3) of this section, the disclosure statement will not be considered late if the taxpayer discloses the reportable transaction by filing a disclosure statement with OTSA within 60 calendar days after the due date of the taxpayer's return (including extensions). The Commissioner in his discretion may issue in published guidance other provisions for disclosure under §1.6011–4.

(2) *Special rules*—(i) *Listed transactions and transactions of interest.* In general, if a transaction becomes a listed transaction or a transaction of interest after the filing of a taxpayer's tax return (including an amended return) reflecting the taxpayer's participation in the listed transaction or transaction of interest and before the end of the period of limitations for assessment of tax for any taxable year in which the taxpayer participated in the listed transaction or transaction of interest, then a disclosure statement must be filed, regardless of whether the taxpayer participated in the transaction in the year the transaction became a listed transaction or a transaction of interest, with OTSA within 90 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. The Commissioner also may determine the time for disclosure of listed transactions and transactions of interest in the published guidance identifying the transaction.

(ii) *Loss transactions.* If a transaction becomes a loss transaction because the losses equal or exceed the threshold amounts as described in paragraph (b)(5)(i) of this section, a disclosure statement must be filed as an attachment to the taxpayer's tax return for the first taxable year in which the threshold amount is reached and to any subsequent tax return that reflects any amount of section 165 loss from the transaction.

(3) *Multiple disclosures.* The taxpayer must disclose the transaction in the time and manner provided for under the provisions of this section regardless of whether the taxpayer also plans to disclose the transaction under other published guidance, for example, §1.6662–3(c)(2).

(4) *Example.* The following example illustrates the application of this paragraph (e):

Example. In January of 2008, F, a calendar year taxpayer, enters into a transaction that at the time is not a listed transaction and is not a transaction described in any of the paragraphs (b)(3) through (7) of this section. All the tax benefits from the transaction are reported on F's 2008 tax return filed timely in April 2009. On May 2, 2011, the IRS publishes a notice identifying the transaction as a listed transaction described in paragraph (b)(2) of this section. Upon issuance of the May 2, 2011 notice, the transaction becomes a reportable transaction described in paragraph (b) of this section. The period of limitations on assessment for F's 2008 taxable year is still open. F is required to file Form 8886 for the transaction with OTSA within 90 calendar days after May 2, 2011.

(f) *Rulings and protective disclosures*—(1) *Rulings.* If a taxpayer requests a ruling on the merits of a specific transaction on or before the date that disclosure would otherwise be required under this section, and receives a favorable ruling as to the transaction, the disclosure rules under this section will be deemed to have been satisfied by that taxpayer with regard to that transaction, so long as the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. If a taxpayer requests a ruling as to whether a specific transaction is a reportable transaction on or before the date that disclosure would otherwise be required under this section, the Commissioner in his discretion may determine that the submission satisfies the disclosure rules under this section for the taxpayer requesting the ruling for that transaction if the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. The potential obligation of the taxpayer to disclose the transaction under this section will not be suspended during the period that the ruling request is pending.

(2) *Protective disclosures.* If a taxpayer is uncertain whether a transaction must be disclosed under this section, the taxpayer may disclose the transaction in accordance with the requirements of this section and comply with all the provisions of this section, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under this section. For a protective disclosure to be effective, the taxpayer must comply with these disclosure regulations by providing to the IRS all information requested by the IRS under this section.

(g) *Retention of documents.* (1) In accordance with the instructions to Form 8886 (or a successor form), the taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure under this section that

are material to an understanding of the tax treatment or tax structure of the transaction. The documents must be retained until the expiration of the statute of limitations applicable to the final taxable year for which disclosure of the transaction was required under this section. (This document retention requirement is in addition to any document retention requirements that section 6001 generally imposes on the taxpayer.) The documents may include the following:

(i) Marketing materials related to the transaction;

(ii) Written analyses used in decision-making related to the transaction;

(iii) Correspondence and agreements between the taxpayer and any advisor, lender, or other party to the reportable transaction that relate to the transaction;

(iv) Documents discussing, referring to, or demonstrating the purported or claimed tax benefits arising from the reportable transaction; and documents, if any, referring to the business purposes for the reportable transaction.

(2) A taxpayer is not required to retain earlier drafts of a document if the taxpayer retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of the document that is material to an understanding of the purported tax treatment or tax structure of the transaction.

(h) *Effective/applicability date*—(1) *In general.* This section applies to transactions entered into on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006. Paragraph (f)(1) of this section applies to ruling requests received on or after November 1, 2006. Otherwise, the rules that apply with respect to transactions entered into before August 3, 2007, are contained in §1.6011–4 in effect prior to August 3, 2007. (See 26 CFR part 1 revised as of April 1, 2007).

(2) [*Reserved*].

§1.6011–4T [Removed]

Par. 3. Section 1.6011–4T is removed.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 4. The authority citation for part 20 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 5. Section 20.6011–4 is revised to read as follows:

§20.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an estate tax under chapter 11 of subtitle B of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 6. The authority citation for part 25 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 7. Section 25.6011–4 is revised to read as follows:

§25.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves a gift tax under chapter 12 of subtitle B of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Par. 8. The authority citation for part 31 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 9. Section 31.6011–4 is revised to read as follows:

§31.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an employment tax under chapters 21 through 25 of subtitle C of the Internal Revenue Code, the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Par. 10. The authority citation for part 53 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 11. Section 53.6011–4 is revised to read as follows:

§53.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 42 of subtitle D of the Internal Revenue Code (relating to private foundations and certain other tax-exempt organizations), the transaction must

be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 54—PENSION EXCISE TAXES

Par. 12. The authority citation for part 54 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 13. Section 54.6011–4 is revised to read as follows:

§54.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2)(ii)(*b*) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 43 of subtitle D of the Internal Revenue Code (relating to qualified pension, etc., plans) the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

PART 56—PUBLIC CHARITY EXCISE TAXES

Par. 14. The authority citation for part 56 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 15. Section 56.6011–4 is revised to read as follows:

§56.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* or a *transaction of interest* as defined in §1.6011–4 of this chapter by the Commissioner in published guidance (see §601.601(d)(2) of this chapter), and the listed transaction or transaction of interest involves an excise tax under chapter 41 of subtitle D of the Internal Revenue Code (relating to public charities), the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective/applicability date.* This section applies to listed transactions entered into on or after January 1, 2003. This section applies to transactions of interest entered into on or after November 2, 2006.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 25, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, 72 F.R. 43146)

Section 6104.—Publicity of Information Required From Certain Exempt Organizations and Certain Trusts

Proposed regulations provide rules relating to information made available by the IRS for public inspection under section 6104(a). See REG-116215-07, page 659.

Section 6110.—Public Inspection of Written Determinations

Proposed regulations provide rules relating to materials that are made publicly available under section 6110. See REG-116215-07, page 659.

Section 6111.—Disclosure of Reportable Transactions

26 CFR 301.6111–3: Disclosure of reportable transactions.

T.D. 9351

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

AJCA Modifications to the Section 6111 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6111 of the Internal Revenue Code that provide the rules relating to the disclosure of reportable transactions by material advisors. These regulations affect material advisors responsible for disclosing reportable transactions under section 6111 and material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend 26 CFR part 301 by providing rules relating to the disclosure of reportable transactions by material advisors under section 6111.

The American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. Section 815 of the AJCA amended section 6111 to require each material advisor with respect to any reportable transaction to make a return (in such form as the Secretary may prescribe) setting forth: (1) information identifying and describing the transaction; (2) infor-

mation describing any potential tax benefits expected to result from the transaction; and (3) such other information as the Secretary may prescribe. Section 6111(a), as amended, also provides that the return must be filed not later than the date specified by the Secretary. Section 6111(b)(1), as amended, provides a definition for the term material advisor and includes as part of that definition a requirement that the material advisor derive certain threshold amounts of gross income that the Secretary may prescribe. The AJCA amendments to section 6111 also authorize the Secretary to prescribe regulations that provide: (1) that only one person shall be required to meet the requirements of section 6111(a) in cases in which two or more persons would otherwise be required to meet such requirements; (2) exemptions from the requirements of section 6111; and (3) rules as may be necessary or appropriate to carry out the purposes of section 6111. Section 815 of the AJCA is effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004.

In response to the AJCA, the IRS and Treasury Department issued interim guidance on section 6111 in Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; Notice 2005–22, 2005–1 C.B. 756; and Notice 2006–6, 2006–1 C.B. 385 (see §601.601(d)(2)). On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on recommendations in the public comments.

Summary of Comments and Explanation of Provisions

Nine written comments were received in response to the NPRM. All comments were considered and are available for public inspection upon request.

Reportable Transaction Number

The proposed regulations provide that a material advisor must provide a reportable transaction number to all taxpayers and material advisors to whom the material advisor makes or provides tax statements. Many commentators commented that the requirement to provide the reportable transaction number to all taxpayers and material advisors to whom the material advisor makes or provides tax statements is overly broad and suggested, instead, that the reportable transaction number only be required to be furnished to those for whom the taxpayer acted as a material advisor. One commentator recommended that the regulation be amended to remove the obligation to provide a reportable transaction number. Another commentator recommended that a material advisor should be required to provide the reportable transaction number to taxpayers only in the case of marketed transactions. The commentator also commented that in a purely one-on-one, non-abusive transaction, the use of the reportable transaction number may infringe upon the attorney-client relationship.

The IRS and Treasury Department attempted to balance the need for disclosure of reportable transactions with the resulting burden imposed upon taxpayers. The IRS and Treasury Department do not believe that requiring a material advisor to provide a reportable transaction number to certain taxpayers and material advisors imposes an undue burden upon taxpayers in light of the benefit to tax administration. However, the IRS and Treasury Department recognize that requiring the reportable transaction number to be provided to all persons for whom the material advisor made a tax statement may be unnecessary. Therefore, these final regulations state that a material advisor is required to provide a reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor.

Material Advisor Fee Threshold Language

The proposed regulations provide, in general, that a lower threshold amount of gross income applies in the case of a reportable transaction when substantially all of the tax benefits are provided to natural persons (looking through any partnerships, S corporations, or trusts). The IRS and Treasury Department received comments asking for clarification of the term "substantially all of the tax benefits."

The final regulations provide that the determination of whether the lower threshold amount applies is based on the facts and circumstances. Generally, unless the facts and circumstances prove otherwise, if 70 percent or more of the tax benefits from a reportable transaction are provided to natural persons (looking through any partnerships, S corporations, or trusts) then substantially all of the tax benefits will be considered to be provided to natural persons.

Material Advisor Disclosure of the Identity of Other Material Advisors

The proposed regulations provide that a material advisor who is required to file a disclosure statement must also disclose the identity of other material advisors. Two commentators recommended that these final regulations be amended to provide that a material advisor must provide the identity of other material advisors only if the material advisor has actual knowledge of such other material advisors.

After carefully considering the recommendation by the commentators, these final regulations provide that a material advisor must provide the identities of any material advisor(s) who the material advisor knows or has reason to know acted as a material advisor with respect to the transaction.

Designation Agreements

The proposed regulations provide that if more than one material advisor is required to disclose a reportable transaction under section 6111, the material advisors may designate by written agreement a single material advisor to disclose the transaction. The designation of one material ad-

visor to disclose the transaction does not relieve the other material advisors of their obligation to disclose the transaction to the IRS in accordance with section 6111, if the designated material advisor fails to disclose the transaction to the IRS in a timely manner. One commentator recommended that a good faith participation in a designation agreement be treated as if the non-designated material advisor has satisfied the advisor's obligations under section 6111 and/or section 6112. The commentator also suggested that if the previous recommendation is not adopted, that these final regulations prohibit designation agreements entirely.

These final regulations do not adopt the recommendation of the commentator. The purpose of the designation agreement language is to reduce the burden on material advisors in complying with the disclosure and list maintenance regulations while balancing the need of the IRS and Treasury Department to receive the necessary information described in sections 6111 and 6112. The designation agreement allows material advisors, if they choose, to have one material advisor comply with the disclosure and list maintenance obligations rather than multiple advisors maintaining duplicative lists. Inherent in the language is the assumption that the designated material advisor will comply with the requirements. Absolving the non-designated material advisors from the obligations listed in sections 6111 and 6112 for good faith designation agreements would require the IRS to determine whether the designation agreement was entered into in good faith and would increase the burdens on tax administration.

Form 8271

Before the enactment of the AJCA, section 6111 provided that tax shelter organizers were required to provide investors in tax shelters the registration number for the tax shelter. Section 301.6111–1T, Q&A 55, requires investors to report the registration number of the tax shelter to the IRS on Form 8271, *"Investor Reporting of Tax Shelter Registration Number"*, and attach the Form 8271 to any return on which any deduction, loss, credit, or other tax benefit attributable to the tax shelter is claimed. Because only a few investors must still file Form 8271 for pre-AJCA section 6111 tax shelters and because the IRS already is aware of these transactions, the IRS and Treasury Department have decided that investors are no longer required to file Forms 8271 otherwise due on or after August 3, 2007. The Form 8271 will be obsoleted. However, these final regulations continue to require that material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the material advisor acts as a material advisor.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 35) do not apply. The return referenced in these regulations will be made available for public comment in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35). Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.6111–3 also issued under 26 U.S.C. 6111.

Par. 2. Section 301.6111–3 is added to read as follows:

§301.6111–3 Disclosure of reportable transactions.

(a) *In general.* Each material advisor, as defined in paragraph (b) of this section, with respect to any reportable transaction, as defined in §1.6011–4(b) of this chapter, must file a return as described in paragraph (d) of this section by the date described in paragraph (e) of this section.

(b) *Material advisor*—(1) *In general.* A person is a material advisor with respect to a transaction if the person provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in paragraph (b)(3) of this section for the material aid, assistance, or advice. The term transaction includes all of the factual elements relevant to the expected tax treatment of any investment, entity, plan or arrangement, and includes any series of steps carried out as part of a plan.

(2) *Material aid, assistance, or advice*—(i) *In general.* Except as provided in paragraph (b)(5) of this section, a person provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any transaction if the person makes or provides a tax statement to or for the benefit of—

(A) A taxpayer who either is required to disclose the transaction under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter because the transaction is a listed transaction or a transaction of interest, or would have been required to disclose the transaction under §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter if the transac-

tion had become a listed transaction or a transaction of interest within the period of limitations in §1.6011–4(e) of this chapter;

(B) A taxpayer who the potential material advisor knows is or reasonably expects to be required to disclose the transaction under §1.6011–4 of this chapter because the transaction is or is reasonably expected to become a transaction described in §1.6011–4(b)(3) through (5) or (7) of this chapter;

(C) A material advisor who is required to disclose the transaction under this section because it is a listed transaction or a transaction of interest; or

(D) A material advisor who the potential material advisor knows is or reasonably expects to be required to disclose the transaction under this section because the transaction is or is reasonably expected to become a transaction described in §1.6011–4(b)(3) through (5) or (7) of this chapter.

(ii) *Tax statement*—(A) *In general.* A tax statement is any statement (including another person's statement), oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction as defined in §1.6011–4(b)(2) through (7) of this chapter. A tax statement under this section includes tax result protection that insures some or all of the tax benefits of a reportable transaction.

(B) *Confidential transactions.* A statement relates to a tax aspect of a transaction that causes it to be a confidential transaction if the statement concerns a tax benefit related to the transaction and either the taxpayer's disclosure of the tax treatment or tax structure of the transaction is limited in the manner described in §1.6011–4(b)(3) of this chapter by or for the benefit of the person making the statement, or the person making the statement knows the taxpayer's disclosure of the tax structure or tax aspects of the transaction is limited in the manner described in §1.6011–4(b)(3) of this chapter.

(C) *Transactions with contractual protection.* A statement relates to a tax aspect of a transaction that causes it to be a transaction with contractual protection if the statement concerns a tax benefit related to the transaction and either—

(*1*) The taxpayer has the right to a full or partial refund of fees paid to the person making the statement or the fees are contingent in the manner described in §1.6011–4(b)(4) of this chapter; or

(*2*) The person making the statement knows or has reason to know that the taxpayer has the right to a full or partial refund of fees (described in §1.6011–4(b)(4)(ii) of this chapter) paid to another if all or part of the intended tax consequences from the transaction are not sustained or that fees (as described in §1.6011–4(b)(4)(ii) of this chapter) paid by the taxpayer to another are contingent on the taxpayer's realization of tax benefits from the transaction in the manner described in §1.6011–4(b)(4) of this chapter.

(D) *Loss transactions.* A statement relates to a tax aspect of a transaction that causes it to be a loss transaction if the statement concerns an item that gives rise to a loss described in §1.6011–4(b)(5) of this chapter.

(E) [*Reserved*].

(iii) *Special rules*—(A) *Capacity as an employee.* A material advisor generally does not include a person who makes a tax statement solely in the person's capacity as an employee, shareholder, partner or agent of another person. Any tax statement made by that person will be attributed to that person's employer, corporation, partnership or principal. However, a person shall be treated as a material advisor if that person forms or avails of an entity with the purpose of avoiding the rules of section 6111 or 6112 or the penalties under section 6707 or 6708.

(B) *Post-filing advice.* A person will not be considered to be a material advisor with respect to a transaction if that person does not make or provide a tax statement regarding the transaction until after the first tax return reflecting tax benefit(s) of the transaction is filed with the IRS. However, this exception does not apply to a person who makes a tax statement with respect to the transaction if it is expected that the taxpayer will file a supplemental or amended return reflecting additional tax benefits from the transaction.

(C) *Publicly filed statements.* A tax statement with respect to a transaction that includes only information about the transaction contained in publicly available documents filed with the Securities and Exchange Commission no later than the close of the transaction will not be considered a tax statement to or for the benefit of a person described in paragraph (b)(2) of this section.

(3) *Gross income derived for material aid, assistance, or advice*—(i) *Threshold amount*—(A) *In general.* The threshold amount of gross income is $50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons (looking through any partnerships, S corporations, or trusts). For all other transactions, the threshold amount is $250,000.

(B) *Listed transactions and transactions of interest.* For listed transactions described in §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter, the threshold amounts in paragraph (b)(3)(i)(A) of this section are reduced from $50,000 to $10,000 and from $250,000 to $25,000. For transactions of interest described in §§1.6011–4, 20.6011–4, 25.6011–4, 31.6011–4, 53.6011–4, 54.6011–4, or 56.6011–4 of this chapter, the threshold amounts in paragraph (b)(3)(i)(A) of this section may be reduced as identified in the published guidance describing the transaction.

(C) [*Reserved*].

(D) *Substantially all of the tax benefits.* For purposes of this section, the determination of whether substantially all of the tax benefits from a reportable transaction are provided to natural persons is made based on all the facts and circumstances. Generally, unless the facts and circumstances prove otherwise, if 70 percent or more of the tax benefits from a reportable transaction are provided to natural persons (looking through any partnerships, S corporations, or trusts) then substantially all of the tax benefits will be considered to be provided to natural persons.

(ii) *Gross income derived directly or indirectly for the material aid, assistance, or advice.* In determining the amount of gross income a person derives directly or indirectly for material aid, assistance, or advice, all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a reportable transaction are taken into account. Fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document

the transaction, and for services to prepare tax returns to the extent return preparation fees are unreasonable in light of all of the facts and circumstances. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property. The IRS will scrutinize carefully all of the facts and circumstances in determining whether consideration received in connection with a reportable transaction constitutes gross income derived directly or indirectly for aid, assistance, or advice. For purposes of this section, the threshold amount must be met independently for each transaction that is a reportable transaction and aggregation of fees among transactions is not required.

(4) *Date a person becomes a material advisor*—(i) *In general.* A person will be treated as becoming a material advisor when all of the following events have occurred (in no particular order)—

(A) The person provides material aid, assistance or advice as described in paragraph (b)(2) of this section;

(B) The person directly or indirectly derives gross income in excess of the threshold amount as described in paragraph (b)(3) of this section; and

(C) The transaction is entered into by the taxpayer to whom or for whose benefit the person provided the tax statement, or in the case of a tax statement provided to another material advisor, when the transaction is entered into by a taxpayer to whom or for whose benefit that material advisor provided a tax statement.

(ii) *Determining if the taxpayer entered into the transaction.* Material advisors, including those who cease providing services before the time the transaction is entered into, must make reasonable and good faith efforts to determine whether the event described in paragraph (b)(4)(i)(C) of this section has occurred.

(iii) *Listed transactions and transactions of interest.* If a transaction that was not a reportable transaction is identified as a listed transaction or a transaction of interest in published guidance after the occurrence of the events described in paragraph (b)(4)(i) of this section, the person will be treated as becoming a material advisor on the date the transaction is identified as a listed transaction or a transaction of interest.

(5) *Other persons designated as material advisors.* Published guidance may identify other types or classes of persons as material advisors.

(c) *Definitions.* For purposes of this section, the following definitions apply:

(1) *Reportable transaction.* The term *reportable transaction* is defined in §1.6011–4(b)(1) of this chapter.

(2) *Listed transaction.* The term *listed transaction* is defined in §1.6011–4(b)(2) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(3) *Derive.* The term *derive* means receive or expect to receive.

(4) *Person.* The term *person* means any person described in section 7701(a)(1), including an affiliated group of corporations that join in the filing of a consolidated return under section 1501.

(5) *Substantially similar.* The term *substantially similar* is defined in §1.6011–4(c)(4) of this chapter.

(6) *Tax.* The term *tax* means Federal tax.

(7) *Tax benefit.* A tax benefit includes deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, status as an entity exempt from Federal income taxation, and any other tax consequences that may reduce a taxpayer's Federal tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit.

(8) *Tax return.* The term *tax return* means a Federal tax return and a Federal information return.

(9) *Tax structure.* The tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed Federal tax treatment of the transaction.

(10) *Tax treatment.* The tax treatment of a transaction is the purported or claimed Federal tax treatment of the transaction.

(11) *Taxpayer.* The term *taxpayer* is defined in §1.6011–4(c)(1) of this chapter.

(12) *Tax result protection.* The term *tax result protection* includes insurance company and other third party products commonly described as tax result insurance.

(13) *Transaction of interest.* The term *transaction of interest* is defined in §1.6011–4(b)(6) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(d) *Form and content of material advisor's disclosure statement*—(1) *In general.* A material advisor required to file a disclosure statement under this section must file a completed Form 8918, *"Material Advisor Disclosure Statement"* (or successor form) in accordance with this paragraph (d) and the instructions to the form. To be considered complete, the information provided on the form must describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and the identity of any material advisor(s) whom the material advisor knows or has reason to know acted as a material advisor as defined in paragraph (b) of this section with respect to the transaction. An incomplete form containing a statement that information will be provided upon request is not considered a complete disclosure statement. A material advisor may file a single form for substantially similar transactions. An amended form must be filed if information previously provided is no longer accurate, if additional information that was not disclosed becomes available, or if there are material changes to the transaction. A material advisor is not required to file an additional form for each additional taxpayer that enters into the same or substantially similar transaction. If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the material advisor will not be considered to have complied with the disclosure requirements of this section.

(2) *Reportable transaction number.* The IRS will issue to a material advisor a reportable transaction number with respect to the disclosed reportable transaction. Receipt of a reportable transaction number does not indicate that the disclosure statement is complete, nor does it indicate that the transaction has been reviewed, examined, or approved by the IRS. Material advisors must provide the reportable transaction number to all taxpayers and material advisors for whom the

material advisor acts as a material advisor as defined in paragraph (b) of this section. The reportable transaction number must be provided at the time the transaction is entered into, or, if the transaction is entered into prior to the material advisor receiving the reportable transaction number, within 60 calendar days from the date the reportable transaction number is mailed to the material advisor.

(e) *Time of providing disclosure*. The material advisor's disclosure statement for a reportable transaction must be filed with the Office of Tax Shelter Analysis (OTSA) by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the reportable transaction or in which the circumstances necessitating an amended disclosure statement occur. The disclosure statement must be sent to OTSA at the address provided in the instructions for Form 8918 (or a successor form).

(f) *Designation agreements*. If more than one material advisor is required to disclose a reportable transaction under this section, the material advisors may designate by written agreement a single material advisor to disclose the transaction. The transaction must be disclosed by the last day of the month following the end of the calendar quarter that includes the earliest date on which a material advisor who is a party to the agreement became a material advisor with respect to the transaction as described in paragraph (b)(4) of this section. The designation of one material advisor to disclose the transaction does not relieve the other material advisors of their obligation to disclose the transaction to the IRS in accordance with this section, if the designated material advisor fails to disclose the transaction to the IRS in a timely manner.

(g) *Protective disclosures*. If a potential material advisor is uncertain whether a transaction must be disclosed under this section, the advisor may disclose the transaction in accordance with the requirements of this section and comply with all the provisions of this section, and indicate on the disclosure statement that the disclosure statement is being filed on a protective basis. The IRS will not treat disclosure statements filed on a protective basis any differently than other disclosure statements filed under this section. For a protective disclosure to be effective, the advisor must comply with the regulations under this section and §301.6112–1 by providing to the IRS all information requested by the IRS under these sections.

(h) *Rulings*. If a potential material advisor requests a ruling as to whether a specific transaction is a reportable transaction on or before the date that disclosure would otherwise be required under this section, the Commissioner in his discretion may determine that the submission satisfies the disclosure rules under this section for that transaction if the request fully discloses all relevant facts relating to the transaction which would otherwise be required to be disclosed under this section. The potential obligation of the person to disclose the transaction under this section (or to maintain or furnish the list under §301.6112–1) will not be suspended during the period that the ruling request is pending.

(i) *Effective/applicability date*—(1) *In general*. This section applies to transactions with respect to which a material advisor makes a tax statement on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006 with respect to which a material advisor makes a tax statement under §301.6111–3 on or after November 2, 2006. Paragraph (h) of this section applies to ruling requests received on or after November 1, 2006. Otherwise, the rules that apply with respect to transactions entered into before August 3, 2007 are contained in Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; and Notice 2005–22, 2005–1 C.B. 756 (see §601.601(d)(2)(ii)(*b*) in effect prior to August 3, 2007.

(2) [*Reserved*].

§301.6111–3T [Removed]

Par. 3. Section 301.6111–3T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 25, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, F.R. 43157)

Section 6112.—Material Advisors of Reportable Transactions Must Keep Lists of Advisees, etc.

26 CFR 301.6112–1: Material advisors of reportable transactions must keep lists of advisees, etc.

T.D. 9352

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

AJCA Modifications to the Section 6112 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6112 of the Internal Revenue Code that provide the rules relating to the obligation of material advisors to prepare and maintain lists with respect to reportable transactions. These regulations affect material advisors responsible for keeping lists under section 6112.

DATES: *Effective Date:* These regulations are effective August 3, 2007.

FOR FURTHER INFORMATION CONTACT: Charles D. Wien, Michael H. Beker, or Tolsun N. Waddle, 202–622–3070; (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this final regulation have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1686. Responses to these collections of information are mandatory. An agency may not conduct or sponsor, and

a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number assigned by the Office of Management and Budget.

The estimated annual burden per recordkeeper for the collection of information in §301.6112–1 is 100 hours and the estimated number of recordkeepers is 500.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books and records relating to these collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains final regulations that amend 26 CFR part 301 by amending the rules relating to the list maintenance requirements of material advisors with respect to reportable transactions under section 6112.

The American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418), (AJCA) was enacted on October 22, 2004. Section 815 of the AJCA amended section 6112 to provide that each material advisor (as defined in section 6111, as amended by the AJCA) with respect to any reportable transaction is required to maintain a list (in such manner as the Secretary may by regulations prescribe) identifying each person with respect to whom the advisor acted as a material advisor with respect to the transaction, and containing other information as the Secretary may by regulations require. Section 815 of the AJCA is effective for transactions with respect to which material aid, assistance, or advice is provided after October 22, 2004. Prior to the amendments to section 6111 made by the AJCA, the definition of material advisor was in §301.6112–1 of the Procedure and Administration Regulations.

On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received and comments made at the hearing, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations but include some modifications based on recommendations in the public comments.

Summary of Comments and Explanation of Provisions

Furnishing of Lists

The proposed regulations provided that each material advisor must prepare and maintain a list for each reportable transaction. The proposed regulations also provided that each list must include three components: an itemized statement, a description of the transaction, and documents. Further, the proposed regulations provided that each material advisor responsible for maintaining a list must, upon written request by the IRS, make each component of the list available to the IRS by furnishing each component of the list to the IRS within 20 business days from the day on which the request is provided. The proposed regulations stated that each component of the list must be furnished to the IRS in a form that enables the IRS to determine without undue delay or difficulty the information required to be on the list. If any component of the list is not in such form, the material advisor will not be considered to have complied with the list maintenance provisions of section 6112 and the regulations thereunder.

Several commentators recommended that the proposed regulations should provide the IRS with flexibility to determine, based on the amount of information required, a production schedule that will be sufficient to avoid the imposition of penalties. Two commentators suggested providing a phased disclosure procedure. One commentator recommended that the 20 business days begin after the advisor had an adequate opportunity to gather the required information. Another commentator recommended amending the proposed regulations to provide a substantial compliance standard.

The IRS and Treasury Department believe that providing the IRS the ability to determine an alternative production schedule will benefit both taxpayers and the IRS. These final regulations remove the language regarding the period for furnishing a list or the components of the list to the IRS because that period will be addressed in forthcoming published guidance under section 6708. In addition, an alternative schedule for furnishing the list or the components of the list will be addressed in published guidance under section 6708.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that most of the information is already required to be reported under the current regulations; the clarifications and new information required by the final regulations add little or no new burden to the existing requirements. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel

for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Charles D. Wien, Michael H. Beker, and Tolsun N. Waddle, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6112–1 is revised to read as follows:

§301.6112–1 Material advisors of reportable transactions must keep lists of advisees, etc.

(a) *In general.* Each material advisor, as defined in §301.6111–3(b), with respect to any reportable transaction, as defined in §1.6011–4(b) of this chapter, shall prepare and maintain a list in accordance with paragraph (b) of this section and shall furnish such list to the Internal Revenue Service (IRS) in accordance with paragraph (e) of this section.

(b) *Preparation and maintenance of lists*—(1) *In general.* A separate list must be prepared and maintained for each reportable transaction. However, one list must be maintained for substantially similar transactions. A list must be maintained in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section. The Commissioner in his discretion may provide in published guidance a form or method for maintaining and/or furnishing the list.

(2) *Persons required to be included on lists.* A material advisor is required to maintain a list identifying each person with respect to whom the advisor acted as a material advisor with respect to the reportable transaction. However, a material advisor is not required to identify a person on the list if the person entered into a listed transaction or a transaction of interest more than 6 years before the transaction was identified in published guidance as a listed transaction or a transaction of interest.

(3) *Contents.* Each list must include the three components described in paragraph (b)(3)(i), (ii), and (iii) of this section.

(i) *Statement.* An itemized statement containing the following information—

(A) The name of each reportable transaction, the citation to the published guidance number identifying the transaction if the transaction is a listed transaction or a transaction of interest, and the reportable transaction number obtained under section 6111;

(B) The name, address, and TIN of each person required to be included on the list;

(C) The date on which each person required to be included on the list entered into each reportable transaction, if known by the material advisor;

(D) The amount invested in each reportable transaction by each person required to be included on the list, if known by the material advisor;

(E) A summary or schedule of the tax treatment that each person is intended or expected to derive from participation in each reportable transaction; and

(F) The name of each other material advisor to the transaction, if known by the material advisor.

(ii) *Description of the transaction.* A detailed description of each reportable transaction that describes both the tax structure of the transaction and the purported tax treatment of the transaction.

(iii) *Documents.* The following documents—

(A) A copy of any designation agreement (as described in paragraph (f) of this section) to which the material advisor is a party; and

(B) Copies of any additional written materials, including tax analyses or opinions, relating to each reportable transaction that are material to an understanding of the purported tax treatment or tax structure of the transaction that have been shown or provided to any person who acquired or may acquire an interest in the transactions, or to their representatives, tax advisors, or agents, by the material advisor or any related party or agent of the material advisor. However, a material advisor is not required to retain earlier drafts of a document provided the material advisor retains a copy of the final document (or, if there is no final document, the most recent draft of the document) and the final document (or most recent draft) contains all the information in the earlier drafts of such document that is material to an understanding of the purported tax treatment or the tax structure of the transaction.

(c) *Definitions.* For purposes of this section, the following terms are defined as:

(1) *Material advisor.* The term *material advisor* is defined in §301.6111–3(b).

(2) *Reportable transaction.* The term *reportable transaction* is defined in §1.6011–4(b)(1) of this chapter.

(3) *Listed transaction.* The term *listed transaction* is defined in §1.6011–4(b)(2) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(4) *Substantially similar.* The term *substantially similar* is defined in §1.6011–4(c)(4) of this chapter.

(5) *Person.* The term *person* is defined in §301.6111–3(c)(4).

(6) *Related party.* A person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

(7) *Tax.* The term *tax* is defined in §301.6111–3(c)(6).

(8) *Tax benefit.* The term *tax benefit* is defined in §301.6111–3(c)(7).

(9) *Tax return.* The term *tax return* is defined in §301.6111–3(c)(8).

(10) *Tax structure.* The term *tax structure* is defined in §301.6111–3(c)(9).

(11) *Tax treatment.* The term *tax treatment* is defined in §301.6111–3(c)(10).

(12) *Transaction of interest.* The term *transaction of interest* is defined in §1.6011–4(b)(6) of this chapter. See also §§20.6011–4(a), 25.6011–4(a), 31.6011–4(a), 53.6011–4(a), 54.6011–4(a), or 56.6011–4(a) of this chapter.

(d) *Retention of lists.* Each material advisor must maintain each component of the list described in paragraph (b)(3) of

this section in a readily accessible form for seven years following the earlier of the date on which the material advisor last made a tax statement relating to the transaction, or the date the transaction was last entered into, if known. If the material advisor required to prepare, maintain, and furnish the list is a corporation, partnership, or other entity (entity) that has dissolved or liquidated before completion of the seven-year period, the person responsible under state law for winding up the affairs of the entity must prepare, maintain and furnish each component of the list on behalf of the entity, unless the entity submits the list to the Office of Tax Shelter Analysis (OTSA) within 60 days after the dissolution or liquidation. If state law does not specify any person as responsible for winding up the affairs, then each of the directors of the corporation, the general partners of the partnership, or the trustees, owners, or members of the entity are responsible for preparing, maintaining and furnishing each component of the list on behalf of the entity, unless the entity submits the list to the OTSA within 60 days after the dissolution or liquidation. The responsible person must also provide notice to OTSA of such dissolution or liquidation within 60 days after the dissolution or liquidation. The list and the notice provided to OTSA must be sent to: Internal Revenue Service, OTSA Mail Stop 4915, 1973 North Rulon White Blvd., Ogden, Utah 84404, or to such other address as provided by the Commissioner.

(e) *Furnishing of lists*—(1) *In general*. Each material advisor responsible for maintaining a list must, upon written request by the IRS, make each component of the list described in paragraph (b)(3) of this section available to the IRS. Each component of the list must be furnished to the IRS in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section. If any component of the list is not in a form that enables the IRS to determine without undue delay or difficulty the information required in paragraph (b)(3) of this section, the material advisor will not be considered to have complied with the list maintenance provisions in section 6112 and this section. A material advisor must make the list or each component of the list available to the IRS within the period prescribed in section 6708 or published guidance relating to section 6708.

(2) *Claims of privilege*. Each material advisor who is required to maintain a list with respect to a reportable transaction, must still maintain the list pursuant to the requirements of this section even if a person asserts a claim of privilege with respect to the information specified in paragraph (b)(3)(iii)(B) of this section.

(f) *Designation agreements*. If more than one material advisor is required to maintain a list of persons for a reportable transaction, in accordance with paragraph (b) of this section, the material advisors may designate by written agreement a single material advisor to maintain the list or a portion of the list. The designation of one material advisor to maintain the list does not relieve the other material advisors from their obligation to furnish the list to the IRS in accordance with paragraph (e)(1) of this section, if the designated material advisor fails to furnish the list to the IRS in a timely manner. A material advisor is not relieved from the requirement of this section because a material advisor is unable to obtain the list from any designated material advisor, any designated material advisor did not maintain a list, or the list maintained by any designated material advisor is not complete.

(g) *Effective/applicability date*. In general, this section applies to transactions with respect to which a material advisor makes a tax statement under §301.6111–3 on or after August 3, 2007. However, this section applies to transactions of interest entered into on or after November 2, 2006, with respect to which a material advisor makes a tax statement under §301.6111–3 on or after November 2, 2006. Otherwise, the rules that apply before August 3, 2007 are contained in §301.6112–1 in effect prior to August 3, 2007 (see 26 CFR part 301 revised as of April 1, 2007, and see also Notice 2004–80, 2004–2 C.B. 963; Notice 2005–17, 2005–1 C.B. 606; and Notice 2005–22, 2005–1 C.B. 756 (see §601.601(d)(2)(ii)(*b*) of this chapter).

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 25, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 31, 2007, 11:22 a.m., and published in the issue of the Federal Register for August 3, 2007, 72 F.R. 43154)

Section 6655.—Failure by Corporation to Pay Estimated Income Tax

26 CFR 1.6655–1: Addition to the tax in the case of a corporation.

T.D. 9347

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Corporate Estimated Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance to corporations with respect to estimated tax requirements. These final regulations generally affect corporate taxpayers who are required to make estimated tax payments. These final regulations reflect changes to the law since 1984. This document also removes the section 6154 regulations.

DATES: *Effective date:* These regulations are effective on August 7, 2007.

Applicability date: These regulations apply to tax years beginning after September 6, 2007.

FOR FURTHER INFORMATION CONTACT: Timothy Sheppard, at (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1), the Procedure and Administration Regulations (26 CFR Part 301), and the OMB Control Numbers under the Paperwork Reduction Act Regulations (26 CFR Part 602) relating to corporate estimated

taxes under section 6425 and section 6655 of the Internal Revenue Code (Code). This document also removes §§1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, 1.6154–5, and 301.6154–1. The IRS is removing the section 6154 regulations because Congress repealed section 6154 in 1987.

These regulations reflect changes to the law made by the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494); the Superfund Amendments and Reauthorization Act of 1986, Public Law 99–499 (100 Stat. 1613); the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085); the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (101 Stat. 1330); the Revenue Act of 1987, Public Law 100–203 (101 Stat. 1330–382); the Omnibus Trade and Competitiveness Act of 1988, Public Law 100–418 (102 Stat. 1107); the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342); the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106); the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388); the Tax Extension Act of 1991, Public Law 102–227 (105 Stat. 1686); the Act of Feb. 7, 1992, Public Law 102–244 (106 Stat. 3); the Unemployment Compensation Amendments of 1992, Public Law 102–318 (106 Stat. 290); the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66 (107 Stat. 312); the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809); the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755); the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788); the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106–170 (113 Stat. 1860); the Community Renewal Tax Relief Act of 2000, Public Law 106–554 (114 Stat. 2763); the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38); the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108–27 (117 Stat. 752); and the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418).

These regulations do not reflect changes made by the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345) (TIPRA), as amended by the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Act of 2007, Public Law 110–28 (121 Stat. 112), because TIPRA made temporary, targeted changes to the time and amount of any required installment otherwise due in September 2010 and September 2011. TIPRA also changed the amount of required installments in 2006, 2012, and 2013 for corporations with assets of not less than $1 billion. Although these changes are not reflected in these regulations, these and any further changes made in the Code supersede the rules in these regulations.

A notice of proposed rulemaking under section 6655 (REG–107722–00, 2006–1 C.B. 354) was published in the **Federal Register** (70 FR 73393) on December 12, 2005. The proposed regulations provide guidance on how to determine the amount of a corporation's estimated tax due with each quarterly installment. No requests for a public hearing were received, so the public hearing on the proposed regulations, scheduled for March 15, 2006, was cancelled. The IRS received written and electronic comments responding to the notice of proposed rulemaking. After consideration of all comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions and Summary of Comments

Section 6655 generally requires corporations to make quarterly estimated tax payments or be assessed an addition to tax for any underpayment. As a general rule, payments are due on the fifteenth day of the fourth, sixth, ninth, and twelfth months. Each quarterly payment must be at least twenty-five percent of the required annual payment in order to avoid an underpayment penalty. Generally, the required annual payment equals one hundred percent of the tax shown on the return for the current year tax, or for certain small taxpayers, the lesser of one hundred percent of the tax shown on the return for the current year tax or one hundred percent of the tax shown on the return for the preceding taxable year. Alternatively, corporations may elect to use an annualized income installment or an adjusted seasonal installment if less than the amount computed under the general rules.

1. *Comments Concerning §1.6655–1 (Addition to Tax in the Case of a Corporation) of the Proposed Regulations*

A. *Recapture of a tax credit not included in the definition of "tax"*

One commentator requested that the final regulations clarify that the recapture of a tax credit under Chapter 1 is not a section 11 tax and not included within the definition of tax for purposes of section 6655 unless there is authority that provides that the recaptured credit is treated as a tax imposed by section 11.

Revenue Ruling 78–257, 1978–1 C.B. 440, provides that the term *tax*, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. However, *Berkshire Hathaway, Inc. v. United States*, 802 F.2d 429 (Fed. Cir. 1986), held that, for purposes of the definition of tax under section 6655, the recapture tax under former section 47 was not a tax imposed by section 11. The Court concluded that because the taxpayer paid no tax imposed by section 11 in the preceding taxable year, that taxpayer was not subject to an addition to tax for failing to pay estimated tax in the current year under the former provision in section 6655(d)(2) that allowed a taxpayer to pay estimated tax in the current year based on the law applicable to (other than the rates), and the known facts of, the prior year's return. Based on the holding in *Berkshire Hathaway*, §1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided in the Internal Revenue Code, for purposes of the definition of tax as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is removed. See §601.601(d)(2)(ii)(*b*).

B. *Tax rate changes for preceding year safe harbor*

Section 6655(d)(1)(B)(ii) allows taxpayers to determine their required annual payment based on 100 percent of the tax shown on the preceding year's return. Commentators suggested that the rule provided in §1.6655–1(g)(3) of the proposed regulations, which requires taxpayers to

recompute the tax determined for the preceding taxable year based on the current year tax rates if the tax rates for the current year and the preceding year differ, is not authorized by section 6655. The commentators suggested that, prior to the effective date of its amendment in 1987, section 6655 allowed estimated tax payments to be based on the facts shown on the return for the preceding taxable year and the law applicable to that year but using the tax rates for the current taxable year. The commentators requested that the final regulations not adopt the rule provided in §1.6655–1(g)(3) of the proposed regulations.

Section 6655 no longer provides specific statutory authority to recompute tax determined for the preceding taxable year using the rates applicable to the current taxable year. Therefore, the final regulations do not adopt the rule provided in §1.6655–1(g)(3) of the proposed regulations.

C. *Return for the preceding taxable year*

One commentator requested that the final regulations clarify that the regulations adopt the holding in *Mendes v. Commissioner*, 121 T.C. 308 (2003). In *Mendes*, the Tax Court held that a tax return that is filed after the IRS issues a notice of deficiency is not a return for purposes of section 6654(d)(1)(B)(i). *Id.* at 324–325. *Mendes* cited *Evans Cooperage Co., Inc. v. United States*, 712 F.2d 199 (5th Cir. 1983), for the proposition that the purpose of the preceding year safe harbor is "to provide a predictable escape from any possible penalty liability [and this purpose] would be defeated if penalties for underpayment of estimated taxes during the year were based, not on the easily determinable amount reflected on the preceding year's return, but instead upon the ultimate tax liability, possibly determined by adverse tax audit, a year or so after the tax year for...which the estimated tax installments were paid." *Mendes*, 121 T.C. at 326 (quoting *Evans Cooperage*, 712 F.2d at 204). *Evans Cooperage* held that the statutory reference to "tax shown on the return of the corporation for the preceding taxable year" refers to the timely filed return for the preceding year, not to any later-filed amended return. *Evans Cooperage*, 712 F.2d at 204.

Section 1.6655–1(g)(2) of the proposed regulations provides that the reference in section 6655(d)(1)(B)(ii) to "return of the corporation of the preceding taxable year" includes the Federal income tax return as amended, only if an amended Federal income tax return has been filed before the due date for an installment. As long as a taxpayer has remaining estimated tax installment payments to make during the tax year and is basing the payments on the preceding year return, the remaining payments should be made based on the most recent information the IRS has on the preceding year return. This includes the information on an amended return for the preceding year filed before an installment due date. Section 1.6655–1(g)(2) of the final regulations retains this rule but clarifies that the term "return for the preceding taxable year" includes the Federal income tax return as amended only if filed before the applicable installment due date if an amended Federal income tax return is filed for the preceding taxable year. If an amended Federal income tax return is filed on or after an installment due date, then the term "return for the preceding taxable year" does not include that amended Federal income tax return with respect to the installments due prior to the time the amended Federal income tax return is filed. This rule applies regardless of whether the IRS issues a notice of deficiency prior to the filing of the amended Federal income tax return.

2. *Comments Concerning §1.6655–2 (Annualized Income Installment Method) of the Proposed Regulations*

As a general comment to the proposed regulations, one commentator noted that the estimated tax payment rules should strive to provide the most accurate picture of annualized taxable income based on facts known as of the end of an annualization period. The IRS and Treasury Department agree with this comment and recognize that treating an annualization period as a short taxable year does not necessarily result in an accurate estimate of annualized taxable income. The final regulations make it clear that taxpayers may not determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year.

Consistent with the general rejection of a short taxable year approach, the final regulations recognize that certain types of items that are generally incurred once (or otherwise infrequently) during the taxable year or that are subject to special exceptions, should not be annualized because doing so would create a distortion in the estimate of annualized taxable income. This approach also recognizes that although distortions may occur in the annualization process due to general fluctuations in the timing of items of income and deductions incurred throughout the year, taxpayers should generally be permitted to rely on such annualized estimates to the extent the estimate is based upon information available to the taxpayer as of the end of the annualization period.

A commentator expressed concern that the rules provided in the proposed regulations were too mechanical and created traps for the unwary. In response to this comment, the final regulations provide rules which are intended to produce a reasonably accurate estimate of annualized taxable income for estimated tax purposes without imposing an undue compliance burden on taxpayers. Specifically, the final regulations address this general concern by allowing taxpayers to make a reasonably accurate allocation of certain items of income or expense. However, a taxpayer's annualized taxable income for estimated tax purposes is primarily based on items of income and expense recognized during the annualization period. Therefore, the annualization method is as inherently complex as computing taxable income.

A. *Reasonably accurate allocation*

Commentators noted that many of the rules provided in the proposed regulations with respect to economic performance and recurring expenses would create significant administrative burdens, result in similarly situated taxpayers being treated differently, and did not further the underlying goal of providing an accurate picture of annualized taxable income.

The final regulations do not retain the recurring expense rules provided in the proposed regulations. The final regulations provide special rules for specific items of deduction that are routinely incurred on an annual basis or for which a

special exception to the general accounting rules exists. Given the nature of these items, applying the general annualization rules to these items could result in a significant distortion in the estimate of annualized taxable income. These items include real property tax deductions; employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation); deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds); items allowed as a deduction for the taxable year by reason of section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule); and items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (IRB) (see §601.601(d)(2)(ii)(*b*)).

The final regulations require that these specified items of deduction be allocated in a reasonably accurate manner. The item of deduction that must be allocated in a reasonably accurate manner includes the total amount of the item of deduction recognized by the taxpayer during the taxable year regardless of whether the item is deemed to be paid or incurred during the taxable year as a result of events that occurred during the taxable year, after the taxable year, or both. While a reasonably accurate allocation may permit certain items to be recognized in an annualization period prior to being paid or incurred, an amount may only be taken into account to the extent the item of deduction is properly recognized by the taxpayer during the taxable year. Therefore, taxpayers will be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a deduction the taxpayer expected to be incurred but was not ultimately recognized as a deduction by the taxpayer in the computation of taxable income for that year.

The final regulations provide that an allocation will be considered to be made in a reasonably accurate manner if the item is allocated ratably throughout the tax year. In addition, an allocation will be considered to be made in a reasonably accurate manner to the extent it provides a reasonable estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. The final regulations provide a list of some relevant factors to be taken into consideration in determining whether an allocation provides a reasonable estimate of taxable income based upon facts known as of the end of the annualization period. The IRS and Treasury Department recognize that various allocations may be considered to be done in a reasonably accurate manner and intend for taxpayers to have flexibility in determining which allocation to use, particularly when use of a specific allocation reduces administrative burdens on the taxpayer. In general, allocations that are made with the intent to distort will not be considered to have been made in a reasonably accurate manner.

Many of the items of deduction which are required to be allocated in a reasonably accurate manner include items that may not have otherwise been allowed to be taken into account by taxpayers (for example, year-end bonus liabilities, items paid after year end) under the general annualization rules to the extent they were deemed to be incurred in the last quarter of the year. In this regard, the final regulations provide a measure of relief to taxpayers with respect to such items. The final regulations provide that the Secretary may designate in future IRB guidance additional items of deduction that are required to be allocated in a reasonably accurate manner. Taxpayers are encouraged to bring items to the attention of the IRS and Treasury Department that they believe should be allocated in a reasonably accurate manner rather than applying the general annualization rules.

Commentators requested that taxpayers be permitted to take the exceptions provided in section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule) into account for purposes of determining items of expense incurred during an annualization period. As noted above, these exceptions frequently apply either to expenses paid annually or to expenses paid after the end of the taxable year. The specific rules and underlying intent of these exceptions do not easily translate to the concept of an annualization period. The final regulations provide that items of expense that utilize these exceptions will be considered to be properly taken into account if they are allocated among annualization periods in a reasonably accurate manner. Therefore, the final regulations permit taxpayers for estimated tax payment purposes to allocate throughout the tax year items of deduction recognized in the taxable year as a result of these exceptions to the extent the allocation is made in a reasonably accurate manner. The final regulations adopt this approach in order to reduce the complexity and burden associated with the computation of estimate taxes by allowing taxpayers to allocate these specific items of expense in a reasonably accurate manner while also preventing unintended distortions under the annualization method.

B. *Net operating loss deductions*

Several commentators addressed provisions in the proposed regulations requiring a net operating loss (NOL) deduction to be taken into account in computing an annualized installment after annualizing the taxable income for the annualization period. One commentator argued that economic performance with respect to an NOL carryover has already occurred and therefore, the NOL deduction should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period. Another commentator suggested that special rules be provided for extraordinary items such as NOL deductions noting the unique nature of such items. Comments were also received suggesting that NOL deductions should be treated the same as any other deduction.

NOL deductions are different from other items of deduction occurring throughout the year in that there is no anticipation that similar deductions will recur throughout the year or in future years. In this regard, NOL deductions are more like extraordinary items. Treating NOL deductions in the same manner as other recurring deductions would be inconsistent with attempting to provide a reasonably accurate picture of annualized taxable income and could result in a distorted estimate of annualized taxable income similar to the distortions created by the various techniques the regulations are intended to prevent. The final regulations treat a NOL deduction as an extraordinary item that is treated as occurring on the first day of the taxable year and is taken

into account after annualization. As a result of the final regulations, Rev. Rul. 67–93, 1967–1 C.B. 366, is removed. See §601.601(d)(2)(ii)(*b*).

C. *Credit carryovers*

One commentator suggested that a credit carryover should be taken into account in computing an annualized installment before annualizing the taxable income for the annualization period because economic performance has occurred for the credit carryover. In general, taxpayers annualize components of a credit for the current taxable year to determine the amount of a credit because the credit is based on components for the current year. However, credit carryovers are generally based on the components for the entire year in which the credit arose. Therefore, the credit carryover already is computed based on annualized components for the year in which the credit arose. Because a credit carryover is based on annualized components, the final regulations provide that a credit carryover must be taken into account after determining the annualized tax and before taking into account the applicable percentage for the annualization period.

D. *Credits incurred in an annualization period and recaptured credits*

One commentator suggested that the final regulations provide that credits incurred in an annualization period are not annualized. The commentator suggested that annualization should be based on the underlying basis for the credit. The commentator also suggested that if a credit is based on an item that is annualized in computing the required installment for the annualization period, the amounts should be annualized in determining the amount of the credit. Finally, the commentator suggested that similar rules should apply to the recapture of credits that are included within the definition of tax.

Section 1.6655–2(f)(3)(iii) of the final regulations provides that the items upon which the credit is computed are annualized pursuant to the provisions of §1.6655–2(f)(1) and the amount of the credit is computed based on the annualized items. The amount of the credit is then deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three-month period are multiplied by four, the credit is determined, and the credit reduces the annualized tax. Reducing the annualized tax by a credit before taking into account the applicable percentage is consistent with the statutory definition of tax provided in section 6655(g)(1) and the annualized income installment method provided in section 6655(e). In order to clarify this rule, §1.6655–2(b)(1) of the final regulations provides that tax means tax after taking into account credits and before applying the applicable percentage. These rules generally do not apply to a credit recapture because, as discussed in heading 1A of the preamble, a credit recapture, such as a recapture provided by section 50(a)(1)(A), is not taken into account when determining the tax for an annualized income installment for purposes of section 6655.

E. *Depreciation and amortization expense*

One commentator requested clarification on the alternative method in §1.6655–2(f)(2)(v)(A) of the proposed regulations. The proposed regulations provide that a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation and amortization (depreciation) expense for the current taxable year attributable to assets that a taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention. Several commentators suggested that the regulations were not clear on how a taxpayer determines how much more than 50 percent may be used and requested that the final regulations provide criteria for making this determination.

Another commentator suggested that the general rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations for taking into account depreciation was impractical for many taxpayers because of the administrative burdens associated with the computation of actual and expected depreciation expense. The commentator also suggested that the rule does not provide an alternative calculation methodology for assets subject to a convention other than the half-year convention or for intangible assets. The commentator requested that the final regulations provide alternative computation methodologies for all depreciable and amortizable assets and allow taxpayers to take into account section 179 deductions. The commentator also requested that the final regulations eliminate the alternative rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations that allows taxpayers to take into account a proportionate amount of 50 percent of taxpayers' current year estimated depreciation expense. The commentator requested that instead the final regulations provide a safe harbor that allows taxpayers to claim a proportionate amount of 90 percent of the prior year depreciation expense for all assets placed in service in an earlier year.

By including the alternative rule in §1.6655–2(f)(2)(v)(A) of the proposed regulations, the IRS and Treasury Department intended to illustrate the minimum amount of depreciation a taxpayer is entitled to take for a taxable year. In response to the comments referenced above, the final regulations do not include the alternative method in §1.6655–2(f)(2)(v)(A) of the proposed regulations. The final regulations provide a general rule that permits taxpayers to estimate their annual depreciation expense and include a proportionate amount of such expense for annualization purposes. The final regulations also provide that, in determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation deductions, and other similar events and provisions that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year. The IRS and Treasury Department believe that prescribing special rules for depreciation is appropriate because unlike many other deductions, depreciation generally accrues ratably throughout the taxable year. Therefore, in contrast to the general annualization rules, the final regulations require depreciation

expense to be taken into account ratably throughout the taxable year.

As an alternative to the general rule for depreciation expense, the final regulations provide two safe harbors. The first safe harbor requires taxpayers to take into account for an annualization period a proportionate amount of depreciation expense allowed for the taxable year from: (1) assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and have not been disposed of during the annualization period; (2) assets that were placed in service during the annualization period and have not been disposed of during that period; and (3) assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period. For purposes of additional first-year depreciation deductions, the final regulations provide that only a proportionate amount of the current year's additional first-year depreciation deduction to be taken into account in determining a taxpayer's taxable income for the taxable year is taken into account in computing taxable income for an annualization period. In addition, the final regulations provide that amounts that the taxpayer deducts under section 179 or any similar provision, are treated the same as additional first-year depreciation.

The second safe harbor included in the final regulations provides that a taxpayer may take into account a proportionate amount of 90 percent of its preceding year's depreciation that is taken on its Federal income tax return for the preceding taxable year. However, if the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account for the preceding taxable year must be put on an annualized basis. In addition, a taxpayer must use whatever depreciation safe harbor method it selects under §1.6655–2(f)(3)(iv)(B) of the final regulations for all depreciation deductions within the annualization period for the annualized income installment but may use a different depreciation method provided in §1.6655–2(f)(3)(iv) for each annualized income installment during the taxable year.

F. *Events arising after the installment due date*

One commentator requested that the final regulations include examples of events that would arise after the installment due date that would be considered reasonably unforeseeable to illustrate the rule provided in §1.6655–2(h) of the proposed regulations. In considering the request for more specific guidance as to what constitutes an unforeseeable event, the IRS and Treasury Department determined that providing relief for certain unforeseeable events would more appropriately be addressed through contemporaneous guidance. Furthermore, the unforeseeable event exception provided in the proposed regulations was inherently subjective and retaining such a rule would be difficult to administer. In addition, certain provisions in the final regulations allow events that occur after the end of an annualization period to be taken into account but only to the extent the anticipated events actually occur. Therefore, the final regulations do not retain the unforeseeable event exception as provided in §1.6655–2(h) of the proposed regulations.

The final regulations do permit taxpayers in specific circumstances to take into account transactions that are properly reflected in the taxpayer's return for a particular year to be taken into account for annualization purposes regardless of when the underlying event giving rise to the item occurs. For example, the final regulations permit taxpayers to defer income related to a transaction to which sections 1031 or 1033 may apply even if the replacement of property required under sections 1031 or 1033 has not occurred as of the end of an annualization period to the extent the taxpayer has a reasonable belief that qualifying replacement property will be acquired.

G. *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*

Section 1.6655–2(g) of the proposed regulations provides that in determining the applicability of the annualized income installment method or the adjusted seasonal installment method, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined with reasonable accuracy by the installment due date. Examples of these items are the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year.

The IRS and Treasury Department believe that the language in §1.6655–2(g) of the proposed regulations could be misinterpreted and broadly applied to items to which the rule was not intended. The final regulations provide that §1.6655–2(g) applies only to the items specifically listed. These items include the inflation index for taxpayers using the dollar-value LIFO inventory method, adjustments required under section 263A, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, section 199 computations, deferred gain under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying property, and to any other item specifically designated in guidance published in the Internal Revenue Bulletin.

H. *Taking into account a section 199 deduction*

Commentators requested clarification on how taxpayers using the annualized income installment method (or the adjusted seasonal installment method) should take into account a section 199 deduction. One commentator suggested that because the section 199 deduction is calculated based on income and expense items incurred during the taxable year and has some characteristics of a credit, the final regulations should treat a section 199 deduction as a credit. Commentators also suggested that the final regulations require taxpayers to annualize income and compute the section 199 deduction based on the annualized amount. Another commentator requested that the final regulations treat a section 199 deduction as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. The commentator requested that the final regulations allow taxpayers to make

a reasonable estimate of the section 199 deduction for purposes of determining the proportionate amount that should be taken into account in determining annualized taxable income.

Although the section 199 deduction is calculated based on income and expense items incurred during the taxable year, the section 199 deduction is a deduction and not a credit. Therefore, a section 199 deduction must be taken into account to reduce taxable income, not to reduce tax. Under the final regulations, a section 199 deduction is computed prior to annualizing the taxable income for the annualization period. However, in recognition that qualification for the section 199 deduction is restricted by various annual limitations that may not be known as of the end any specific annualization period, the final regulations provide that a section 199 deduction should be treated as an item that substantially affects taxable income but cannot be accurately determined by the installment due date. Therefore, the final regulations permit taxpayers to make a reasonable estimate of the section 199 deduction for purposes of determining the amount to be taken into account in determining annualized taxable income.

I. *Section 263A expenses*

One commentator suggested that the proposed regulations do not provide rules on how taxpayers should account for section 263A adjustments to compute annualized taxable income. The commentator requested that the final regulations not require taxpayers to compute an actual section 263A adjustment for an installment period because this computation would create a significant administrative burden for taxpayers. The commentator also requested that the final regulations provide simplifying rules that allow taxpayers to compute the section 263A adjustment for an installment period by multiplying the prior year's absorption ratio by the inventory on hand at the end of the annualization period or by estimating the annual adjustment and prorating it to each annualization period.

Section 263A expenses are added to the items covered by the rules provided in §1.6655–2(g) of the final regulations for items that substantially affect taxable income but cannot be accurately determined by the installment due date. Therefore, taxpayers may use reasonable estimates from existing data with respect to the amount of adjustments required under section 263A if that amount cannot be determined with reasonable accuracy by the installment due date.

J. *LIFO*

One commentator noted that although the proposed regulations provide simplifying rules to determine the internal inflation index for taxpayers using internal dollar-value LIFO inventory methods, the proposed regulations do not provide rules for taxpayers to determine an external inflation index under the inventory price index computation (IPIC) LIFO method. The commentator requested that the final regulations include a rule that allows taxpayers to determine an estimated external inflation index by multiplying the prior year inventory mix by the applicable inflation index for the annualization period. The commentator also requested that the final regulations include a rule that allows a taxpayer that elected to use final indices to use preliminary indices if the final indices for the appropriate month have not been published. The dollar-value LIFO inventory method includes the use of external indexes, such as the IPIC LIFO method, as well as internal indexes. Therefore, the IRS and Treasury Department do not believe that a separate rule is necessary for the use of external inflation indexes.

K. *Advance payment*

One commentator noted that the proposed regulations do not address how a taxpayer who defers revenue either under §1.451–5(c) or Rev. Proc. 2004–34, 2004–1 C.B. 991, should account for an advance payment to determine annualized taxable income. Section 1.451–5(c) and Rev. Proc. 2004–34 generally allow a taxpayer to defer recognition of a qualifying advance payment for a limited time but only to the extent that financial statements also defer recognition of the income. The commentator requested that the final regulations include a rule that allows a taxpayer using the deferral method under §1.451–5(c) or Rev. Proc. 2004–34 to not recognize an advance payment as income in the annualization period until the advance payment is recognized in the taxpayer's applicable financial statements for the annualization period. The commentator also requested that the final regulations allow a taxpayer using a deferral method to recognize any portion of an advance payment on the last day of the taxable year in which the advance payment is required to be recognized under §1.451–5(c) or Rev. Proc. 2004–34, if that portion of the advance payment is not recognized in the taxpayer's financial statements for any of the annualization periods arising within the limited time provided in §1.451–5(c) or Rev. Proc. 2004–34. See §601.601(d)(2)(ii)(*b*).

The IRS and Treasury Department agree with the commentator that the final regulations should specifically address advance payments and that the rule should be consistent with §1.451–5 and Rev. Proc. 2004–34. Pursuant to §1.6655–2(f)(3)(i)(A) of the final regulations, if the taxpayer uses the method of accounting provided in §1.451–5(b)(1)(ii) for an advance payment, the advance payment is includible in computing taxable income under that method of accounting except that, if §1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which a substantial advance payment is received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year. In addition, §1.6655–2(f)(3)(i)(B) of the final regulations provides that if the taxpayer uses the deferral method provided in section 5.02 of Rev. Proc. 2004–34 for an advance payment, the advance payment is includible in computing taxable income under that method of accounting for annualization purposes. But any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year. The final regulations provide an example involving an advance payment.

L. *Extraordinary items*

One commentator suggested that the final regulations provide special treatment for extraordinary items for purposes

of computing annualized taxable income and suggested that the regulations consider the extraordinary items listed in §1.1502–76(b)(2)(ii)(C). The commentator requested that the final regulations not require taxpayers to take into account extraordinary items under the general rules of §1.6655–2(f) of the proposed regulations because doing so would result in a distortion of annualized taxable income. The commentator requested that extraordinary items be taken into account after annualizing taxable income. The commentator requested that the final regulations provide that taxpayers begin to account for extraordinary items in the annualization period in which the extraordinary event occurs or, alternatively, in the annualization period in which it becomes reasonably foreseeable that the extraordinary event will occur. The commentator also requested that the final regulations provide an exclusive list of extraordinary items by referring to the list of extraordinary items in §1.1502–76(b)(2)(ii)(C) with certain modifications.

The IRS and Treasury Department agree with the commentator that the annualization of extraordinary items could result in a distortion of annualized taxable income. The final regulations include a list of extraordinary items similar to the items in §1.1502–76(b)(2)(ii)(C). Included in the list of extraordinary items in the final regulations are NOL deductions and section 481(a) adjustments. In addition, the final regulations also provide a *de minimis* rule wherein only extraordinary items in excess of $1,000,0000 will be required to be accounted for after annualizing taxable income. However, this *de minimis* rule does not apply to NOL deductions and section 481(a) adjustments.

M. *Section 481(a) adjustments*

The rule in §1.6655–2(f)(2)(iv) of the proposed regulations provides that a taxpayer takes into account a section 481(a) adjustment related to an automatic accounting method change during an annualization period only if a copy of the Form 3115, *"Application for Change in Accounting Method"*, has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by §1.6655–2(f)(2)(iv) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in §1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in §1.6655–2(f)(2)(iv)(B)(*1*) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account section 481(a) adjustments for an automatic accounting method change if they anticipate that the change will be timely filed. The commentator also suggested that if the final regulations adopt the rule in §1.6655–2(f)(2)(v) of the proposed regulations that allows taxpayers to anticipate capital expenditures to estimate depreciation expense for an annualization period, the final regulations should provide a similar rule for automatic accounting method changes by allowing taxpayers to take into account section 481(a) adjustments resulting from anticipated filings for automatic accounting method changes.

The final regulations provide that, in general, any section 481(a) adjustment that results from a change in accounting method that is approved by the Commissioner and properly reflected in the taxpayer's return for the tax year is taken into account as an extraordinary item deemed to occur on the first day of the tax year for annualization purposes. The final regulations provide that a section 481(a) adjustment may be taken into account in this manner notwithstanding (i) the annualization period in which the Form 3115 is filed (including requests filed after year-end), (ii) whether the requested change in accounting method is considered an automatic or non-automatic accounting method change request, (iii) whether the section 481(a) adjustment is positive or negative, and (iv) the date on which the taxpayer receives the approval of the Commissioner. In allowing for a section 481(a) adjustment to be taken into account in this manner, taxpayers should be aware that they will be subject to a section 6655 addition to tax for an underpayment of estimated tax in an installment period caused from taking into account a section 481(a) adjustment the taxpayer expected to be incurred but for which the taxpayer does not receive the consent of the Commissioner to change its method of accounting for that particular tax year. The final regulations also provide an exception to the general rule. Under the exception a taxpayer may choose to treat the filing of a Form 3115 as the date on which the extraordinary item is deemed to occur rather than the first day of the tax year but only with respect to the section 481(a) adjustment (or a portion thereof) that is recognized in the year of change. Use of this exception will impact the period in which the taxpayer will be required to take into account the new method of accounting as provided in §1.6655–6.

N. *Simplify the 52/53 week taxable year rules*

One commentator suggested that the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations are too complex and administratively burdensome. The commentator suggested that the final regulations not include the 52/53 week taxable year rules in §1.6655–2(e) of the proposed regulations and rely on the general concept of annualization. The commentator suggested that taxpayers with 52/53 week taxable years under section 441(f) know how to annualize their applicable annualization period without the rules provided by §1.6655–2(e) of the proposed regulations.

The purpose of the annualized income installment method is to give taxpayers a method of determining annualized income based on the actual facts that occur in the annualization period. Therefore, with limited exceptions, the IRS and Treasury Department drafted the proposed regulations and these final regulations to provide rules that only allow taxpayers to take into account items of income and expense that arise in the applicable annualization period. The IRS and Treasury Department recognize that the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations are complex. Although the final regulations retain the 52/53 week taxable year rules provided by §1.6655–2(e) of the proposed regulations, the final regulations also provide a safe harbor that allows a taxpayer with a 52/53 week taxable year to determine its annu-

alization period on the month that ends closest to the end of its applicable thirteen-week period or four-week period that ends within the applicable annualization period. However, an eligible taxpayer may only use this safe harbor if it is used for determining annualization periods for all required installments for the taxable year.

O. *Controlled foreign corporations, partnerships, and other pass-through entities*

One commentator suggested that the final regulations provide rules on how taxpayers should take into account distributions from a section 936 corporation or a controlled foreign corporation to determine annualized taxable income for an installment period. The commentator also suggested that the final regulations provide rules on how taxpayers should take into account a distributive share of income from passthrough entities other than partnerships, such as trusts, S corporations, and real estate investment trusts (REITs), to determine annualized taxable income for an installment period. The commentator requested that the final regulations expand the scope of §1.6655–2(f)(2)(vi) of the proposed regulations to incorporate the statutory provisions for section 936(h), section 951(a), and closely held REITs, and also provide rules to take into account the distributive share of income received from other types of passthrough entities.

Section 1.6655–2(f)(3)(v) of the final regulations expands the rule in §1.6655–2(f)(2)(vi) of the proposed regulations to provide for the statutory rules in section 6655(e)(4) and section 6655(e)(5) for taking into account subpart F income, income under section 936(h), and dividends received by closely held REITs when computing any annualized income installment. In addition, §1.6655–2(f)(3)(v)(D) adds a rule that requires items from passthrough entities other than partnerships and closely held REITs to be taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under §1.6655–2(f)(3)(v)(A) of the final regulations.

3. *Comments Concerning §1.6655–3 (Adjusted Seasonal Installment Method) of the Proposed Regulations*

A. *Adjusted seasonal installment method and alternative minimum tax*

One commentator suggested that the determination of whether a corporation qualifies for the adjusted seasonal installment method under section 6655(e)(3), and the amount of the required installment under this method, is based only on the corporation's taxable income and tax on that taxable income. The commentator requested that the final regulations clarify that a corporation using the adjusted seasonal installment method is only required to make estimated tax payments with respect to taxable income and tax on that taxable income, and not on the alternative minimum tax (AMT) or any other tax. Any required installment must include AMT because AMT is included in the definition of tax in section 6655(g)(1) and §1.6655–1(g)(1) of the final regulations. Including AMT in the determination of tax is consistent with the general annualization method and adjusted seasonal installment method and recognizes the overall separate and parallel nature of the AMT. Therefore, §1.6655–3(d)(4) of the final regulations provides that the amount of an installment determined using the adjusted seasonal installment method must properly take into account the amount of any AMT under section 55 that would apply for the period of the computation. For this purpose, the amount of any AMT that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and AMT, the rules provided in §1.6655–3(c) of the final regulations for determining the amount of an installment using the adjusted seasonal installment method.

B. *Adjusted seasonal installment method base period percentage*

Section 6655(e)(3)(D)(i) provides that the base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the 3 preceding taxable years bears to the taxable income for the 3 preceding taxable years. One commentator requested that the final regulations clarify whether the base period percentage provided in §1.6655–3(d)(1) of the proposed regulations can be negative.

The rule provided in section 6655(e)(3)(D)(i) requires that the base period percentage be computed based on taxable income. The rule does not provide that taxpayers take into account a loss. Therefore, a taxpayer can never have a negative base period percentage. The lowest number the base period percentage can equal is zero. Section 1.6655–3(d)(1) of the final regulations provides that the base period percentage is computed based on taxable income, which the IRS and Treasury Department believe provides a clear rule that an overall loss for the applicable period of months used to calculate the base period percentage cannot be used to compute the base period percentage. If a taxpayer has an overall loss for an applicable period of months used in the computation of the base period percentage, the taxpayer must use zero in place of the loss.

4. *Comments Concerning §1.6655–4 (Large Corporations) of the Proposed Regulations*

A. *Section 381 transactions to determine large corporation status*

One commentator requested that the final regulations modify the rules in §1.6655–4(c)(2) of the proposed regulations to clarify that, when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation, the adjustment for the section 381 transaction relates only to the portion of taxable income applicable to the transferred assets.

Generally, for a transaction to qualify under section 381, an acquiring corporation must acquire a majority of the assets of the acquired corporation. Section 1.6655–4(c)(2) of the proposed regulations provides that when determining if a corporation is a large corporation for a taxable year in which a section 381 transaction occurs, an acquiring corporation must include in its income the distributor or transferor corporation's income for the taxable year up to and including the date of distribution or transfer. This rule requires the acquiring corporation to include 100 percent of the distributor or transferor

corporation's taxable income (or loss) in the acquiring corporation's income even if the acquiring corporation acquires less than 100 percent of the assets of the distributor or transferor corporation as long as section 381 applies to the transaction. The final regulations do not include a rule providing that the adjustment for a section 381 transaction relates only to the portion of taxable income applicable to the transferred assets when computing taxable income for a year in which there is a section 381 transaction to determine if a corporation is a large corporation. The IRS and Treasury Department believe that such a rule would be unnecessarily complex considering that the rule in the proposed regulations is both taxpayer favorable (if there are losses of the distributor or transferor corporation) and taxpayer unfavorable (if there is taxable income of the distributor or transferor corporation) and considering that in these transactions, the acquiring corporation generally acquires a majority of the distributor or transferor corporation's assets. However, §1.6655–4(c)(2)(i)(B) of the final regulations amends §1.6655–4(c)(2)(i)(B) of the proposed regulations to clarify that an acquiring corporation takes into account the distributor or transferor corporation's taxable income or loss for purposes of determining whether a corporation is a large corporation for a taxable year in which a section 381 transaction occurs.

B. *Aggregation*

One commentator suggested that the rule provided by §1.6655–4(d)(2) of the proposed regulations, which does not allow taxpayers to take into account a taxable loss of a member of a controlled group of corporations for a taxable year during the testing period, results in a distorted view of the taxable income of the controlled group of corporations. The commentator requested that the final regulations modify the rule in §1.6655–4(d)(2) of the proposed regulations to allow taxpayers to take into account losses of a member of a controlled group of corporations when determining whether a corporation is considered a large taxpayer because this is consistent with the principles for the computation of consolidated taxable income.

Section 6655(g)(2)(B)(ii) requires that the $1,000,000 exemption be divided among members of a controlled group under rules similar to the rules of section 1561. The purpose of the statute is to limit members of a controlled group, as an aggregate, to $1,000,000 of exemption from large corporation treatment. The aggregation rule in §1.6655–4(d)(2) is intended to allow a controlled group to quickly determine whether the controlled group must allocate the $1,000,000 limitation among the members of the group. It is not intended to treat the controlled group as a single taxpayer, in which all members of the group will be treated as a large corporation, if the taxable income of the controlled group, as an aggregate, is over $1,000,000. Thus, for example, if member A of a controlled group had taxable income of $900,000 and member B of the group had taxable income greater than $1,000,000, the controlled group could choose to allocate $900,000 to member A so that member A will not be treated as a large corporation, but member B would be treated as a large corporation no matter how much of the $1,000,000 limitation is allocated to member B. This is consistent with the rules under section 1561.

5. *Comments Concerning §1.6655–5 (Short Taxable Years) of the Proposed Regulations*

A. *Taxpayer's initial taxable year*

One commentator noted that a taxpayer is not required to choose its taxable year until it files a tax return on its chosen basis in accordance with §1.441–1(c)(1). The commentator requested that the final regulations modify the rule in §1.6655–5(c)(1)(ii) of the proposed regulations to provide that a taxpayer will not be penalized if, in its initial taxable year, it makes estimated tax payments based on a presumption that the taxpayer will have a taxable year that is a calendar year even if the taxpayer subsequently chooses a fiscal year.

Because a taxpayer has until the date it files its initial tax return to choose its taxable year, the final regulations modify the rule in §1.6655–5(c)(1)(ii) of the proposed regulations to allow a taxpayer with an initial short taxable year to make estimated tax payments as though it chose to be a calendar year taxpayer until the taxpayer files its return for its initial short taxable year. Pursuant to this modified rule, a taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year.

B. *Taxpayer's final taxable year*

One commentator suggested that §§1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations provide rules that may require taxpayers with short taxable years to make installment payments based on an applicable percentage that is more than the standard 25 percent per installment period. The commentator suggested that these rules may result in a section 6655 addition to tax being imposed on a taxpayer who makes annualization payments based on 25 percent of its annualized tax and later in the year discovers that, due to an unforeseen termination of its tax year, it should have made its annualization payments based on a higher applicable percentage because it will have fewer than four installment payments. The commentator also suggested that the rule in §1.6655–2(h) of the proposed regulations, which addresses events arising after an installment due date that were not reasonably foreseeable, does not appear to protect a taxpayer that makes an installment payment based on 25 percent of its annualized tax and later discovers that it should have based its installment payment on a higher applicable percentage because it had an unforeseen termination of its tax year resulting in a short taxable year. The commentator requested that the final regulations revise the rules in §§1.6655–5(d)(1), 1.6655–5(d)(2), and 1.6655–5(d)(3) of the proposed regulations so that payments made for an installment period in a short taxable year do not exceed 25 percent. As an alternative, the commentator requested that the final regulations revise the rules in §1.6655–2(h) of the proposed regulations to allow a taxpayer with an unexpected termination of its tax year to make a payment with its final required installment equal to the remaining portion of 100 percent of its required annual payment to avoid a penalty on its earlier required installments.

A taxpayer should not be penalized for making payments based on the appli-

cable percentage of 25 percent for each installment period when it does not know that it will have an early termination year that will result in it making less than four installment payments. Therefore, §1.6655–5(d)(4) of the final regulations provides a rule addressing the applicable percentage for an installment period in which the taxpayer does not reasonably expect that the taxable year will be an early termination year. In the case of any required installment determined under section 6655(e) in which the taxpayer does not know that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) and §1.6655–5(d)(3)(i) of the final regulations is the applicable percentage for each installment period with the remaining balance of the estimated tax payment for the year due with the final installment.

C. *Internal Revenue Manual provisions and annualizing taxable income in an initial or final taxable year*

One commentator noted that Internal Revenue Manual Part 20.1.3.6.3(2) provides that a corporation filing a short period return that is either an initial or final return is not required to annualize its taxable income to compute the penalty. The commentator requested that the final regulations clarify this rule.

The rule in IRM 20.1.3.6.3(2) provides that if a taxpayer has a short taxable year that is either an initial or final year, the taxpayer should not annualize its taxable income based on a full 12 month period. Instead, the taxpayer should annualize its taxable income based on the number of months in the short taxable year. This rule was intended to be provided in §1.6655–5(g)(2) of the proposed regulations. However, the computational rule in §1.6655–5(g)(2) of the proposed regulations is incorrect and does not result in the computation of the correct amount for every installment payment during a short taxable year. The final regulations revise the rule in §1.6655–5(g)(2) of the proposed regulations to provide that a taxpayer computes its annualized income installment by determining the tax on the basis of the annualized income for the annualization period, dividing the resulting tax by 12, multiplying that result by the number of months in the short taxable year, and finally multiplying that result by the applicable percentage for the annualized income installment. The final regulations also revise an example to reflect the new computational rule.

D. *Preceding taxable year rule for large corporations when the preceding taxable year is a short year*

One commentator suggested that the rule provided in §1.6655–5(h) of the proposed regulations, which requires taxpayers to compute the preceding year tax on an annual basis if the preceding taxable year was a short taxable year when using section 6655(d)(2) to determine their first installment, is not authorized by section 6655. Consistent with §1.6655–1(g)(3), the final regulations do not adopt the rule provided in §1.6655–5(h) of the proposed regulations.

6. *Change in method of accounting*

The rule in §1.6655–6(b) of the proposed regulations provides that if a taxpayer is making a change in method of accounting for the current taxable year that is permitted to be made with the automatic consent of the Commissioner, the new method is used in determining any required installment if, and only if, a copy of the Form 3115 has been mailed to the IRS National Office on or before the last day of the annualization period. One commentator suggested that the rule provided by §1.6655–6(b) of the proposed regulations creates administrative burdens for taxpayers, is inconsistent with the depreciation and amortization rules provided in §1.6655–2(f)(2)(v) of the proposed regulations, and could result in the filing of incomplete Forms 3115. The commentator suggested that the rule in §1.6655–6(b) of the proposed regulations causes an administrative burden by requiring taxpayers to recompute taxable income using a different method of accounting than would be used to calculate taxpayers' tax provision for financial accounting purposes, which generally allows taxpayers to take into account an automatic accounting method change if they anticipate that the change will be timely filed.

Consistent with the rules for section 481(a) adjustments as discussed in heading (2)(M) above, the final regulations require a taxpayer to take into account any change in method of accounting for which the taxpayer has received the consent of the Commissioner in the same manner the taxpayer chooses to treat the section 481(a) adjustment resulting from such a change (for example, as of the first day of the taxable year or as of the date the Form 3115 was filed). For a change in accounting method that does not result in a section 481(a) adjustment, the final regulations provide that in the year of change the taxpayer will have the choice for annualization purposes to either use the new method as of the first day of the taxable year or as of the date the Form 3115 was filed.

Effect on Other Documents

The following publications are obsolete for tax years beginning after September 6, 2007:

Revenue Ruling 67–93, 1967–1 C.B. 366.

Revenue Ruling 76–450, 1976–2 C.B. 444.

Revenue Ruling 78–257, 1978–1 C.B. 440.

Revenue Ruling 67–93, 1967–1 C.B. 366, provides that the entire amount of a net operating loss carryover should be deducted from income prior to annualization under the annualized income installment method. The rationale underlying the conclusion in Rev. Rul. 67–93 was based on the position that each annualization period should be treated as a short taxable year. The final regulations specifically provide that an annualization period is not treated as a short taxable year. Therefore, Rev. Rul. 67–93 will be removed when the final regulations are effective.

Revenue Ruling 76–450, 1976–2 C.B. 444, provides that state property tax and franchise tax are deductible from the income for an annualization period on the date the taxpayer accrues the taxes under the taxpayer's method of accounting. Revenue Ruling 76–450 was issued prior to the enactment of section 461(h) and does not take into account the application of the economic performance requirements of section 461(h) for purposes of computing an estimated tax payment using the annualized income installment method. The final regulations provide specific rules related to address the application of section 461(h) and real property taxes for purposes of the annualized income installment

method. As a result of the rules provided in the final regulations, Rev. Rul. 76–450 is no longer applicable and will be removed when the final regulations are effective. See §601.601(d)(2)(ii)(*b*).

Revenue Ruling 78–257, 1978–1 C.B. 440, provides that the term tax, as defined in section 6655, includes the amount of tax resulting from the recomputation of a prior year's investment credit at the applicable rate for the current year. In Rev. Rul. 78–257, a corporation incurred a net operating loss in 1975 but showed an amount of tax from the recomputation of the prior year's investment credit. For 1976 the corporation had a liability for income tax but made no deposits of estimated tax, relying on the former provision in section 6655 that allowed a taxpayer to base its estimated tax payments on an amount equal to the tax computed at the rates applicable to the taxable year but otherwise on the basis of the facts shown on the return of the corporation for, and the law applicable to, the preceding taxable year. The revenue ruling concludes that the corporation was subject to an addition to tax for the underpayment of estimated tax because it failed to pay on or before the prescribed installment due dates an amount equal to the tax resulting from the recomputation of the prior year's investment credit. However, as discussed in heading (1)(A) of the preamble, based on the holding in *Berkshire Hathaway, Inc. v. United States*, 802 F.2d 429 (Fed. Cir. 1986), §1.6655–1(g)(1)(iii) of the final regulations provides that, unless otherwise provided, for purposes of the definition of *tax* as used in section 6655, a recapture of tax, such as a recapture provided by section 50(a)(1)(A) and any other similar provision, is not considered to be a tax imposed by section 11. Therefore, Rev. Rul. 78–257 is no longer applicable and will be removed when the final regulations are effective. See §601.601(d)(2)(ii)(*b*).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Except with respect to §1.6655–5, which deals with the rules applicable to a short taxable year, it has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these provisions do not impose a collection of information on small businesses, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. With respect to §1.6655–5, it is hereby certified that this provision of the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that not many small businesses are going to be subject to the short taxable year rules because: (1) existing small businesses generally are not targets of mergers and acquisitions, which result in a short taxable year; (2) start-up small businesses with a short taxable year of less than four months do not have to pay estimated taxes; and (3) start-up small businesses with a short taxable year of four months or more are not likely to have taxable income that would be subject to the corporate estimated tax rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal authors of these regulations are Joseph P. Dewald, formerly of the Office of Associate Chief Counsel (Procedure and Administration), and Timothy S. Sheppard, Office of Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6655–5 also issued under 26 U.S.C. 6655(i)(2). * * *

Par. 2. In §1.56–0 the heading for paragraph (e)(5) is added to read as follows:

§1.56–0 Table of contents to §1.56–1, adjustment for book income of corporations.

* * * * *

(e) * * *

(5) Effective/applicability date.

Par. 3. Section 1.56–1(e)(4) is revised and paragraph (e)(5) is added to read as follows:

§1.56–1 Adjustment for the book income of corporations.

* * * * *

(e) * * *

(4) *Estimating the book income adjustment for purposes of the estimated tax liability.* See §1.6655–7, as contained in 26 CFR part 1 revised as of April 1, 2007, for special rules for estimating the corporate alternative minimum tax book income adjustment under the annualization exception.

(5) *Effective/applicability date.* Paragraph (e)(4) of this section is applicable for taxable years beginning after September 6, 2007.

§§1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 [Removed]

Par. 4. Sections 1.6154–1, 1.6154–2, 1.6154–3, 1.6154–4, and 1.6154–5 are removed.

Par. 5. Section 1.6425–2(a) is revised and paragraph (c) is added to read as follows:

§1.6425–2 Computation of adjustment of overpayment of estimated tax.

(a) *Income tax liability defined.* For purposes of §1.6425–1, this section, §§1.6425–3 and 1.6655–7, relating to excessive adjustment, the term *income tax liability* means the excess of—

(1) The sum of—

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable; plus

(ii) The tax imposed by section 55; over

(2) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

* * * * *

(c) *Effective/applicability date.* Paragraph (a) of this section is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

Par. 6. Section 1.6425–3 is amended by revising paragraph (f) to read as follows:

§1.6425–3 Allowance of adjustments.

* * * * *

(f) *Effect of adjustment.* (1) For purposes of all sections of the Internal Revenue Code except section 6655, relating to additions to tax for failure to pay estimated income tax, any adjustment under section 6425 is to be treated as a reduction of prior estimated tax payments as of the date the credit is allowed or the refund is paid. For the purpose of sections 6655(a) through (g), (i), and (j), credit or refund of an adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed. However, an excessive adjustment under section 6425 is taken into account in applying the addition to tax under section 6655(h).

(2) For the effect of an excessive adjustment under section 6425, see §1.6655–7.

(3) *Effective/applicability date*: This paragraph (f) is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after September 6, 2007.

Par. 7. Section 1.6655–0 is added to read as follows:

§1.6655–0 Table of contents.

This section lists the table of contents for §§1.6655–1 through 1.6655–7.

§1.6655–1 Addition to the tax in the case of a corporation.

(a) In general.
(b) Amount of underpayment.
(c) Period of the underpayment.
(d) Amount of required installment.
(1) In general.
(2) Exception.
(e) Large corporation required to pay 100 percent of current year tax.
(1) In general.
(2) May use last year's tax for first installment.
(f) Required installment due dates.
(1) Number of required installments.
(2) Time for payment of installments.
(i) Calendar year.
(ii) Fiscal year.
(iii) Short taxable year.
(iv) Partial month.
(g) Definitions.
(h) Special rules for consolidated returns.
(i) Overpayments applied to subsequent taxable year's estimated tax.
(1) In general.
(2) Subsequent examinations.
(j) Examples.
(k) Effective/applicability date.

§1.6655–2 Annualized income installment method.

(a) In general.
(b) Determination of annualized income installment—in general.
(c) Special rules.
(1) Applicable percentage.
(2) Partial month.
(3) Annualization period not a short taxable year.
(d) Election of different annualization periods.
(e) 52–53 week taxable year.
(f) Determination of taxable income for an annualization period.
(1) In general.
(i) Items of income.
(ii) Items of deduction.
(iii) Losses.
(2) Certain deductions required to be allocated in a reasonably accurate manner.
(i) In general.
(ii) Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items.
(iii) Reasonably accurate manner defined.
(iv) Special rule for certain real property tax liabilities.
(v) Examples.
(3) Special rules.
(i) Advance payments.
(A) Advance payments under §1.451–5(b)(1)(ii).
(B) Advance payments under Rev. Proc. 2004–34.
(ii) Extraordinary items.
(A) In general.
(B) *De minimis* extraordinary items.
(C) Special rules for net operating loss deductions and section 481(a) adjustments.
(iii) Credits.
(A) Current year credits.
(B) Credit carryovers.
(iv) Depreciation and amortization.
(A) Estimated annual depreciation and amortization.
(B) Safe harbors.
(*1*) Proportionate depreciation allowance.
(*2*) 90 percent of preceding year's depreciation.
(*3*) Safe harbor operational rules.
(C) Short taxable years.
(v) Distributive share of items.
(A) Member of partnership.
(B) Treatment of subpart F income and income under section 936(h).
(*1*) General rule.
(*2*) Prior year safe harbor.
(*i*) General rule.
(*ii*) Special rule for noncontrolling shareholder.
(C) Dividends from closely held real estate investment trust.
(*1*) General rule.
(*2*) Closely held real estate investment trust.
(D) Other passthrough entities.
(vi) Alternative minimum taxable income exemption amount.
(vii) Examples.
(g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date.
(1) In general.
(2) Example.
(h) Effective/applicability date.

§1.6655–3 Adjusted seasonal installment method.

(a) In general.
(b) Limitation on application of section.
(c) Determination of amount.
(d) Special rules.
(1) Base period percentage.
(2) Filing month.
(3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.
(4) Alternative minimum tax.
(e) Example.

(f) Effective/applicability date.

§1.6655–4 Large corporations.

(a) Large corporation defined.
(b) Testing period.
(c) Computation of taxable income during testing period.
(1) Short taxable year.
(2) Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.
(d) Members of controlled group.
(1) In general.
(2) Aggregation.
(3) Allocation rule.
(4) Controlled group members.
(e) Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.
(f) Consolidated returns. [Reserved]
(g) Example.
(h) Effective/applicability date.

§1.6655–5 Short taxable year.

(a) In general.
(b) Exception to payment of estimated tax.
(c) Installment due dates.
(1) In general.
(i) Taxable year of at least four months but less than twelve months.
(ii) Exceptions.
(2) Early termination of taxable year.
(i) In general.
(ii) Exception.
(d) Amount due for required installment.
(1) In general.
(2) Tax shown on the return for the preceding taxable year.
(3) Applicable percentage.
(4) Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year.
(e) Examples.
(f) 52 or 53 week taxable year.
(g) Use of annualized income or seasonal installment method.
(1) In general.
(2) Computation of annualized income installment.
(3) Annualization period for final required installment.
(4) Examples.
(h) Effective/applicability date.

§1.6655–6 Methods of accounting.

(a) In general.
(b) Accounting method changes.
(c) Examples.
(d) Effective/applicability date.

§1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

Par. 8. Sections 1.6655–1 and 1.6655–2 are revised to read as follows:

§1.6655–1 Addition to the tax in the case of a corporation.

(a) *In general.* Section 6655 imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any underpayment of estimated tax by a corporation. An addition to tax due to the underpayment of estimated taxes is determined by applying the underpayment rate established under section 6621 to the amount of the underpayment, for the period of the underpayment. This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

(b) *Amount of underpayment.* The amount of the underpayment for any required installment is the excess of—

(1) The required installment; over

(2) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(c) *Period of the underpayment.* The period of the underpayment of any required installment runs from the date the installment was required to be paid to the 15th day of the 3rd month following the close of the taxable year, or to the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment a payment of estimated tax will be credited against unpaid required installments in the order in which such installments are required to be paid.

(d) *Amount of required installment*—(1) *In general.* Except as otherwise provided in this section and §§1.6655–2 through 1.6655–7, the amount of any required installment is 25 percent of the lesser of—

(i) 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year); or

(ii) 100 percent of the tax shown on the return for the preceding taxable year.

(2) *Exception.* This paragraph (d)(1)(ii) does not apply if the preceding taxable year was not a taxable year of 12 months or the corporation did not file a return for the preceding taxable year showing a liability for tax.

(e) *Large corporation required to pay 100 percent of current year tax*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, paragraph (d)(1)(ii) of this section does not apply in the case of a large corporation (as defined in §1.6655–4).

(2) *May use last year's tax for first installment.* Paragraph (e)(1) of this section does not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding sentence is recaptured by increasing the amount of the next required installment determined under paragraph (d)(1)(i) of this section by the amount of such reduction and, if the next required installment is reduced by use of the annualized income installment method under §1.6655–2 or the adjusted seasonal installment method under §1.6655–3, by increasing subsequent required installments determined under paragraph (d)(1)(i) of this section to the extent that the reduction has not previously been recaptured.

(f) *Required installment due dates*—(1) *Number of required installments.* Unless otherwise provided, corporations must make 4 required installments for each taxable year.

(2) *Time for payment of installments*—(i) *Calendar year.* Unless otherwise provided, in the case of a calendar year taxpayer, the due dates of the required installments are as follows:

1st	April 15
2nd	June 15
3rd	September 15
4th	December 15

(ii) *Fiscal year.* In the case of a taxpayer other than a calendar year taxpayer, the due dates of the required installments are as follows:

1^{st}	15th day of 4^{th} month of the taxable year
2^{nd}	15th day of 6^{th} month of the taxable year
3^{rd}	15th day of 9^{th} month of the taxable year
4^{th}	15th day of 12^{th} month of the taxable year

(iii) *Short taxable year.* See §1.6655–5 for rules regarding required installments for corporations with a short taxable year.

(iv) *Partial month.* Except as otherwise provided, for purposes of determining the due date of any required installment, a partial month is treated as a full month.

(g) *Definitions.* (1) The term *tax* as used in this section and §§1.6655–2 through 1.6655–7 means the excess of—

(i) The sum of—

(A) The tax imposed by section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable;

(B) The tax imposed by section 55; plus

(C) The tax imposed by section 887; over

(ii) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(2)(i) In the case of a foreign corporation subject to taxation under section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, the tax imposed by section 881 is treated as a tax imposed by section 11.

(ii) In the case of a partnership that is treated, pursuant to regulations issued under section 1446(f)(2), as a corporation for purposes of this section, the tax imposed by section 1446 is treated as a tax imposed by section 11.

(iii) Unless otherwise provided in the Internal Revenue Code or Treasury regulations, for purposes of the definition of "tax" as used in this section, a recapture of tax, such as a recapture provided by section 50(a)(1)(A), and any other similar provision, is not considered to be a tax imposed by section 11.

(iv) For the purposes of paragraph (d) of this section, the return for the preceding taxable year is the Federal income tax return for such taxable year that is required by section 6012(a)(2). However, if an amended Federal income tax return has been filed before the due date of an installment, then the return for the preceding taxable year is the Federal income tax return as amended. If an amended Federal income tax return has been filed on or after the due date for an installment, then the return for the preceding taxable year does not include for such installment period the Federal income tax return as amended subsequent to the due date for such installment. Paragraph (d) of this section will apply without regard to whether the taxpayer's Federal income tax return for the preceding taxable year is filed in a timely manner.

(h) *Special rules for consolidated returns.* For special rules relating to the determination of the amount of the underpayment in the case of a corporation whose income is included in a consolidated return, see §1.1502–5(b).

(i) *Overpayments applied to subsequent taxable year's estimated tax*—(1) *In general.* If a taxpayer elects under the provisions of sections 6402(b) and 6513(d) and the regulations to apply an overpayment in year one against the estimated tax liability for year two, the overpayment will be applied to the required installment payments for year two in the order due and to the extent necessary to satisfy such installments, similar to the manner in which an actual overpayment of one installment is carried forward to the next installment. No interest is accrued or paid on an overpayment if the election to apply the overpayment against estimated tax is made.

(2) *Subsequent examinations.* If a deficiency is determined in an examination of a return for a taxable year that originally reflected an overpayment that was applied against estimated tax for the succeeding taxable year, interest on the deficiency will not begin to accrue on an amount applied until that amount is used to satisfy a required estimated tax payment in such taxable year. Regardless of whether the taxpayer anticipated the application of such overpayment from the prior taxable year in calculating and paying its required estimated tax installment liabilities for the current taxable year, the subsequently determined underpayment and interest computation thereon will not change the taxpayer's original election to apply the overpayment against the estimated tax liability of the succeeding taxable year. Any changes to the usage of the original overpayment from the prior taxable year are hypothetical only and solely for the purpose of computing deficiency interest. Overpayment interest will not be impacted. For further guidance, see Rev. Rul. 99–40, 1999–2 C.B. 441, (see §601.601(d)(2)(ii)(*b*) of this chapter).

(j) *Examples.* The method prescribed in paragraphs (d) through (g) of this section is illustrated by the following examples:

Example 1. (i) X, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $85,000. X is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. X reported a liability of $74,900 on its return for the taxable year ended December 31, 2008, with no credits against tax. X paid four installments of estimated tax, each in the amount of $18,725 (25 percent of $74,900), on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reported a tax liability of $88,900 on its return due March 15, 2010. X had a $5,000 credit against tax for tax year 2009 as provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code. X did not underpay its estimated tax for tax year 2009 for any of the four installments, determined as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 ($88,900-$5,000) =	$83,900
(B) Tax as defined in paragraph (g) of this section for 2008 =	$74,900
(C) 100% of the lesser of this paragraph (j), *Example 1* (i)(A) or (i)(B) =	$74,900

(D) Amount of estimated tax required to be paid on or before each installment date (25% of $74,900) =	$18,725
(E) Deduct amount paid on or before each installment date =	$18,725
(F) Amount of underpayment for each installment date =	$0

(ii) [Reserved].

Example 2. (i) *Facts.* Y, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2009, will be $70,000. Y is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. Y reported a Federal income tax liability of $90,000 for its taxable year ending December 31, 2008. Y paid no installment of estimated tax on or before April 15, 2009, June 15, 2009, or September 15, 2009, but made a payment of $63,000 on December 15, 2009. On March 15, 2010, Y filed its income tax return showing a tax of $70,000. Y had no credits against tax for tax year 2009. Of the $63,000 paid by Y on December 15, 2009, $17,500 is applied to each of the first three installments due on April 15, June 15, and September 15, 2009, and the remaining $10,500 is applied to the fourth installment. Y has an underpayment of estimated tax for each of the first three installments of $17,500 and for the fourth installment of $7,000. The addition to tax under section 6655(a) is computed as follows:

(A) Tax as defined in paragraph (g) of this section for 2009 =	$70,000
(B) Tax as defined in paragraph (g) of this section for 2008 =	$90,000
(C) 100% of the lesser of this paragraph (j), *Example 2* (i)(A) or (i)(B) =	$70,000
(D) Amount of estimated tax required to be paid on or before each installment date (25% of $70,000) =	$17,500
(E) Amount paid on or before the first, second, and third installment dates =	$0
(F) Amount paid on or before the fourth installment date =	$63,000
(G) Amount of underpayment for each of the first, second, and third installment dates =	$17,500
(H) Amount of underpayment for the fourth installment date =	$ 7,000

(ii) *Addition to tax.* Assuming that neither the annualized income installment method nor the adjusted seasonal installment method described in §§1.6655–2 and 1.6655–3 would result in a lower payment for any installment period, and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent *per annum* for the applicable periods of underpayment, the addition to tax is determined as follows:

(A) First installment (underpayment period 4–16–09 through 12–15–09), computed as 244/365 X $17,500 X 8% =	$ 936
(B) Second installment (underpayment period 6–16–09 through 12–15–09), computed as 183/365 X $17,500 X 8% =	$ 702
(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as 91/365 X $17,500 X 8% =	$ 349
(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as 90/365 X $7,000 X 8% =	$ 138
(E) Total of this paragraph (j), *Example 2* (ii)(A) through (D) =	$2,125

(k) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§1.6655–2 Annualized income installment method.

(a) *In general.* In the case of any required installment, if the corporation establishes that the annualized income installment determined under this section, or the adjusted seasonal installment determined under §1.6655–3, is less than the amount determined under §1.6655–1—

(1) The amount of such required installment is the annualized income installment (or, if less, the adjusted seasonal installment); and

(2) Any reduction in a required installment resulting from the application of this section will be recaptured by increasing the amount of the next required installment determined under §1.6655–1 by the amount of such reduction (and, if the next required installment is similarly reduced, by increasing subsequent required installments to the extent that the reduction has not previously been recaptured).

(b) *Determination of annualized income installment—in general.* In the case of any required installment, the annualized income installment is the excess (if any) of—

(1) The product of the applicable percentage and the tax (after reducing the annualized tax by the amount of any allowable credits) for the taxable year computed by annualizing the taxable income and alternative minimum taxable income—

(i) For the first 3 months of the taxable year, in the case of the first required installment;

(ii) For the first 3 months of the taxable year, in the case of the second required installment;

(iii) For the first 6 months of the taxable year, in the case of the third required installment; and

(iv) For the first 9 months of the taxable year, in the case of the fourth required installment; over

(2) The aggregate amount of any prior required installments for the taxable year.

(c) *Special rules*—(1) *Applicable percentage*. Except as otherwise provided in §1.6655–5(d) with respect to short taxable years—

In the case of the following required installments:	The applicable percentage is:
1st	25%
2nd	50%
3rd	75%
4th	100%

(2) *Partial month*. Except as otherwise provided, for purposes of paragraph (b) of this section a partial month is treated as a month.

(3) *Annualization period not a short taxable year*. An annualization period is not treated as a short taxable year for purposes of determining the taxable income of an annualization period.

(d) *Election of different annualization periods*. (1) If the taxpayer timely files Form 8842, *"Election To Use Different Annualization Periods for Corporate Estimated Tax,"* in accordance with section 6655(e)(2)(C)(iii), and elects Option 1—

(i) Paragraph (b)(1)(i) of this section will be applied by using the language "2 months" instead of "3 months";

(ii) Paragraph (b)(1)(ii) of this section will be applied by using the language "4 months" instead of "3 months";

(iii) Paragraph (b)(1)(iii) of this section will be applied by using the language "7 months" instead of "6 months"; and

(iv) Paragraph (b)(1)(iv) of this section will be applied by using the language "10 months" instead of "9 months".

(2) If the taxpayer timely files Form 8842, in accordance with section 6655(e)(2)(C)(iii), and elects Option 2—

(i) Paragraph (b)(1)(ii) of this section will be applied by using the language "5 months" instead of "3 months";

(ii) Paragraph (b)(1)(iii) of this section will be applied by using the language "8 months" instead of "6 months"; and

(iii) Paragraph (b)(1)(iv) of this section will be applied by using the language "11 months" instead of "9 months".

(3) The application of the annualized income installment method is illustrated by the following example:

Example. (i) ABC, a calendar year corporation, had a taxable year of less than twelve months for tax year 2008 and no credits against tax for tax year 2009. ABC made an estimated tax payment of $15,000 on the installment dates of April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. Assume that, under paragraph (d)(1) of this section, ABC elected Option 1 by timely filing Form 8842, in accordance with section 6655(e)(2)(C)(iii), and determined that its taxable income for the first 2, 4, 7 and 10 months was $25,000, $64,000, $125,000, and $175,000 respectively. The income for each period is annualized as follows:

$25,000 X 12/2 =	$150,000
$64,000 X 12/4 =	$192,000
$125,000 X 12/7 =	$214,286
$175,000 X 12/10 =	$210,000

(ii)(A) To determine whether the installment payment made on April 15, 2009, equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 2-month period, the following computation is necessary:

(*1*) Annualized income for the 2 month period =	$150,000
(*2*) Tax on this paragraph (d)(3), *Example* (ii)(A)(*1*) =	$ 41,750
(*3*) 100% of this paragraph (d)(3), *Example* (ii)(A)(*2*) =	$ 41,750
(*4*) 25% of this paragraph (d)(3), *Example* (ii)(A)(*3*) =	$ 10,438

(B) Because the total amount of estimated tax that was timely paid on or before the first installment date ($15,000) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period ($10,438), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the installment payments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 4-month period, the following computation is necessary:

(*1*) Annualized income for the 4 month period =	$192,000
(*2*) Tax on this paragraph (d)(3), *Example* (iii)(A)(*1*) =	$ 58,130
(*3*) 100% of this paragraph (d)(3), *Example* (iii)(A)(*2*) =	$ 58,130
(*4*) 50% of this paragraph (d)(3), *Example* (iii)(A)(*3*) less $10,438 (amount due with the first installment) =	$ 18,627

(B) Because the total amount of estimated tax actually paid on or before the second installment date ($19,562 ($15,000 second required installment payment plus $4,562 overpayment of first required installment)) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period ($18,627), the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 7-month period, the following computation is necessary:

(*1*) Annualized income for the 7 month period =	$214,286
(*2*) Tax on this paragraph (d)(3), *Example* (iv)(A)(*1*) =	$ 66,821
(*3*) 100% of this paragraph (d)(3), *Example* (iv)(A)(*2*) =	$ 66,821
(*4*) 75% of this paragraph (d)(3), *Example* (iv)(A)(*3*) less $29,065 (amount due with the first and second installment) =	$ 21,051

(B) Because the total amount of estimated tax actually paid on or before the third installment date ($15,935 ($15,000 third required installment payment plus $935 overpayment of second required installment)) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period ($21,051), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 2009, installment unless another exception applies to this installment payment.

(v)(A) To determine whether the installment payments made on or before December 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 10-month period, the following computation is necessary:

(*1*) Annualized income for the 10 month period =	$210,000
(*2*) Tax on this paragraph (d)(3), *Example* (v)(A)(*1*) =	$ 65,150
(*3*) 100% of this paragraph (d)(3), *Example* (v)(A)(*2*) =	$ 65,150
(*4*) 100% of this paragraph (d)(3), *Example* (v)(A)(*3*) less $50,116 (amount due with the first, second and third installment) =	$ 15,034

(B) Because the total amount of estimated tax payments made on or before the fourth installment date that is available to be applied to the estimated tax due for the fourth installment ($9,884 ($15,000 fourth required installment payment less $5,116 underpayment for the third installment of estimated tax ($21,051 third installment of estimated tax due less $15,935 payments available to be applied to the third installment of estimated tax))) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 10-month period ($15,034), the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 2009, installment unless another exception applies to this installment payment.

(vi) Assuming that no other exceptions apply and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent *per annum* for the applicable periods of underpayment, the amount of the addition to tax is as follows:

(A) First installment (no underpayment) =	$0
(B) Second installment (no underpayment) =	$0
(C) Third installment (underpayment period 9–16–09 through 12–15–09), computed as 91/365 X $5,116 X 8% =	$102
(D) Fourth installment (underpayment period 12–16–09 through 3–15–10), computed as 90/365 X $5,150 X 8% =	$102
(E) Total of this paragraph (d)(3), *Example* (vi)(A) through (D) =	$204

(e) *52–53 week taxable year*. (1) Generally, except as provided in the alternative rule in paragraph (e)(4) of this section, in the case of a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f), the rules prescribed by §1.441–2 are applicable in determining—

(i) Whether a taxable year is a taxable year of 12 months; and

(ii) When the 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable) commences and ends for purposes of paragraphs (b)(1), (d)(1) and (d)(2) of this section.

(2) If a taxpayer employs four 13-week periods or thirteen 4-week accounting periods and the end of any accounting period employed by the taxpayer does not correspond to the end of the 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable), then, provided the taxpayer has at least one full 4-week or 13-week accounting period, as appropriate, within the applicable period, annualized taxable income for the applicable period is—

(i) [(x/(y*13))*z], in the case of a taxpayer using four 13-week periods, if—

(A) x = Taxable income for the number of full 13-week periods in the applicable period;

(B) y = The number of full 13-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year; or

(ii) [(x/(y*4))*z], in the case of a taxpayer using thirteen 4-week periods, if—

(A) x = Taxable income for the number of full 4-week periods in the applicable period;

(B) y = The number of full 4-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year.

(3) If a taxpayer employs four 13-week periods and the taxpayer does not have at least one 13-week period within the applicable 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period, the taxpayer is permitted to determine annualized taxable income for the applicable period based upon—

(i) The taxable income for the number of weeks in the applicable period; or

(ii) The taxable income for the full 13-week periods that end before the due date of the required installment.

(4) As an alternative to using the 52/53 week taxable year rules provided in paragraphs (e)(1), (e)(2), and (e)(3) of this section, a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f) may base its annualization period on the month that ends closest to the end of its applicable 4-week period or 13-week period that ends within the applicable annualization period. This alternative may only be used if it is used for determining annualization periods for all required installments for the taxable year.

(5) The following examples illustrate the rules of this paragraph (e):

Example 1. Corporation ABC, an accrual method taxpayer, uses a 52/53 week year-end ending on the last Friday in December and uses four thirteen-week periods. For its year beginning December 28, 2007, ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installments. For purposes of computing its first and second required installments, the first 3 months of A's taxable year under paragraph (b)(1)(i) of this section will end on March 28th, the thirteenth Friday of ABC's taxable year. For purposes of its third required installment, the first 6 months of ABC's taxable year will end on June 27th, the twenty-sixth Friday of ABC's taxable year. For purposes of its fourth required installment, the first 9 months of ABC's taxable year will end on September 26th, the thirty-ninth Friday of ABC's taxable year.

Example 2. Same facts as *Example 1* except that ABC uses thirteen four-week periods and there are 52 weeks during ABC's taxable year beginning December 28, 2007, and ending December 26, 2008. For purposes of computing ABC's first and second required installments, ABC's annualized taxable income for the first three months will be the taxable income for the first three four-week periods of ABC's taxable year (December 28, 2007, through March 21, 2008) divided by 12 (number of full four-week periods in the first three months (3) multiplied by 4) and multiplied by 52 (the number of weeks in the taxable year). For purposes of computing ABC's third required installment, ABC's annualized taxable income for the first six months will be the taxable income for the first six four-week periods of ABC's taxable year (December 28, 2007, through June 13, 2008) divided by 24 and multiplied by 52. For purposes of computing ABC's fourth required installment, ABC's annualized taxable income for the first nine months will be the taxable income for the first nine four-week periods of ABC's taxable year (December 28, 2007, through September 5, 2008) divided by 36 and multiplied by 52.

Example 3. Same facts as *Example 1* except that ABC uses the alternative method under paragraph (e)(4) of this section for computing its required installments for 2008. For purposes of computing its first and second required installments, the first three months of ABC's taxable year under paragraph (b)(1)(i) of this section will end on March 31, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the first and second required installments. For purposes of ABC's third required installment, the first six months of ABC's taxable year will end on June 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the third required installment. For purposes of ABC's fourth required installment, the first nine months of ABC's taxable year will end on September 30, 2008, the month that ends closest to the end of ABC's applicable thirteen-week period for the fourth required installment.

(f) *Determination of taxable income for an annualization period*—(1) *In general.* This paragraph (f) applies for purposes of determining the applicability of the exception described in paragraphs (a) and (b) of this section (relating to the annualization of income) and the exception described in §1.6655–3 (relating to annualization of income for corporations with seasonal income). An item of income, deduction, gain or loss is to be taken into account in determining the taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for an annualization period in the manner provided in this paragraph (f). An item may not be taken into account in determining taxable income for any annualization period unless the item is properly taken into account by the last day of that annualization period and the item is properly taken into account in determining the taxpayer's taxable income and alternative minimum taxable income (and applicable tax and alternative minimum tax) for the taxable year that includes the annualization period.

(i) *Items of income.* An item of income is taken into account in the annualization period in which the item is properly includible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, section 451 for accrual method taxpayers, section 453 for installment sales or section 460 for long-term contracts).

(ii) *Items of deduction.* An item of deduction is taken into account in the annualization period in which the item is properly deductible under the method of accounting employed by the taxpayer with respect to the item and in accordance with the appropriate provision of the Internal Revenue Code (for example, under the cash receipts and disbursements method of accounting, the deduction must be paid under §1.461–1(a)(1) and be otherwise deductible in computing taxable income; under an accrual method of accounting, the deduction must be incurred under §1.461–1(a)(2) and be otherwise deductible in computing taxable income). Section 170(a)(2) and §1.170A–11(b) (charitable contributions by accrual method corporations) and §1.461–5 (recurring item exception) may not be taken into consideration by an accrual method taxpayer in any annualization period in determining whether an item of deduction has been incurred under §1.461–1(a)(2) during that annualization period.

(iii) *Losses.* An item of loss is to be taken into account during the annualization period in which events have occurred that permit the loss to be taken into account under the appropriate provision of the Internal Revenue Code.

(2) *Certain deductions required to be allocated in a reasonably accurate manner*—(i) *In general.* The following deductions allowed for a taxable year must be allocated throughout the taxable year in a reasonably accurate manner (as defined in paragraph (f)(2)(iii) of this section), regardless of the annualization period in which the item is paid or incurred:

(A) Real property tax deductions.

(B) Employee and independent contractor bonus compensation deductions (including the employer's share of employment taxes related to such compensation).

(C) Deductions under sections 404 (deferred compensation) and 419 (welfare benefit funds).

(D) Items allowed as a deduction for the taxable year by reason of section 170(a)(2) and §1.170A–11(b) (certain charitable contributions by accrual method corporations), §1.461–5 (recurring item exception) or §1.263(a)–4(f) (12-month rule).

(E) Items of deduction designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Application of the reasonably accurate manner requirement to certain charitable contributions, recurring items, and 12-month rule items.* For purposes of paragraph (f)(2)(i)(D) of this section, the total amount of the item deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner, notwithstanding the fact that section 170(a)(2) and §1.170A–11(b), §1.461–5, or §1.263(a)–4(f) applies to only a portion of the total amount of the item deducted for the taxable year. For example, if a portion of a taxpayer's rebate liabilities are deducted in the computation of taxable income under the recurring item exception, all rebate liabilities deducted in the computation of taxable income for the taxable year must be allocated in a reasonably accurate manner.

(iii) *Reasonably accurate manner defined.* (A) An item is allocated throughout the taxable year in a reasonably accurate manner if the item is allocated ratably throughout the taxable year or if the allocation provides a reasonably accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. In determining that an allocation of an item provides a reasonably accurate estimate of taxable income for the taxable year, relevant considerations include—

(*1*) The extent to which the allocation is consistent with the taxpayer's accounting for the item on its non-tax books and records;

(*2*) The extent to which the allocable portion of the item becomes fixed and determinable (under §1.461–1(a)(2)) during the applicable annualization period; and

(*3*) The extent to which the allocation, if compared to the ratable allocation of the item, results in a better matching of the item of deduction to revenue, earnings, the use of property or the provision of services occurring during the annualization period.

(B) None of the relevant considerations above override the general requirement that the allocation must be done in a reasonably accurate manner based upon the facts known as of the end of the annualization period. For example, the fact that a liability for an annual expense becomes fixed and determinable during an annualization period will not establish that allocating all of the expense to that annualization period has been done in a reasonably accurate manner if the facts known as of the end of the annualization period indicate otherwise.

(iv) *Special rule for certain real property tax liabilities.* Notwithstanding paragraph (f)(2)(iii) of this section, real property tax liabilities for which an election under section 461(c) is in effect must be allocated ratably throughout the taxable year for purposes of this section.

(v) *Examples.* Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3–6–9 annualization period:

Example 1. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $500,000 to its employees if earnings remain constant throughout the tax year. ABC does not pay any of the estimated bonus liability as of March 31, 2008. On October 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on November 15, 2008, and properly deducted in ABC's December 31, 2008, tax year. No other bonus liabilities are incurred by ABC during the tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC is permitted to recognize a $150,000 bonus deduction (one quarter of the $600,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008.

Example 2. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays an annual bonus to its employees. ABC's employee bonus plan generally calls for an annual bonus equal to 2% of earnings. A bonus reserve for this amount is reported each quarter in ABC's non-tax books and records. ABC's quarterly revenues throughout the year are $10,000,000; $6,000,000; $7,000,000; and $7,000,000 respectively. As of March 31, 2008, ABC estimates that it will pay a year-end bonus of $800,000 ($10,000,000 x 4 x 2%) to its employees if earnings remain constant throughout the year. ABC does not pay any of the estimated bonus payment as of March 31, 2008. On December 31, 2008, ABC declares a $600,000 bonus to its employees which is paid out on January 15, 2009, and properly deducted in ABC's December 31, 2008, tax year.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC must allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section, ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the allocation provides a reasonable estimate of taxable income based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimated that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $800,000 ($10,000,000 first quarter earnings x 4 x 2%). Allocating $200,000 ($10,000,000 x 2%) of ABC's annual bonus liability of $600,000 to ABC's first quarter based upon earnings during the quarter represents a better matching of ABC's bonus expense to earnings in the quarter as compared to allocating $150,000 to ABC's first quarter under a ratable accrual method and is consistent with the allocation provided in ABC's non-tax books and records. Accordingly, allocating ABC's employee bonus deductions based upon ABC's earnings will be considered allocated in a reasonably accurate manner.

Example 3. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has adopted a plan under which ABC pays a bonus to its employees each quarter based upon earnings for that quarter. On March 31, 2008, ABC pays out $2,000,000 to its employees as a quarterly bonus based upon the earnings of ABC for the period January 1, 2008, through March 31, 2008. The $2,000,000 bonus is recognized as an expense on ABC's audited financial statements in the quarter ending March 31, 2008. As of March 31, 2008, ABC anticipates that its earnings will continue throughout the year resulting in future quarterly bonus payments in 2008 similar to the $2,000,000 first quarter payment.

(ii) Under the general rule provided in paragraph (f)(2)(i) of this section, ABC is required to allocate its employee bonus liability in a reasonably accurate manner for annualization purposes. Under paragraph (f)(2)(iii) of this section , ABC's employee bonus liability will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC may recognize a $500,000 bonus deduction (one quarter of the $2,000,000 bonus liability properly recognized by ABC in the tax year ending December 31, 2008) in the first annualization period ending March 31, 2008 (as well as one quarter of any additional bonus liabil-

ity properly recognized by ABC in the tax year ending December 31, 2008).

(iii) In addition, paragraph (f)(2)(iii) of this section provides that an allocation will be considered reasonable if the allocation provides an accurate estimate of taxable income for the taxable year based upon the facts known as of the end of the annualization period. Based upon its earnings activities and other information available as of March 31, 2008, ABC estimates that its total deduction for employee bonuses for the taxable year ending December 31, 2008, would be $8,000,000. In addition, the $2,000,000 bonus liability became fixed and determinable during the first quarter. Allocating $2,000,000 to ABC's first quarter earnings is also consistent with ABC's non-tax books and records and represents a better matching of ABC's bonus expense to earnings in the quarter as compared to a ratable accrual. Accordingly, allocating ABC's bonus liability based upon earnings will be considered a reasonably accurate manner for estimated tax purposes.

Example 4. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting with the recurring item exception and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. ABC regularly incurs rebate obligations related to the sale of its products. Rebate coupons that are received and validated by ABC are generally paid in the following month. During the tax year ending December 31, 2009, ABC received, validated and paid $400,000 in rebates. In addition, as of the end of December 31, 2009, ABC had received and validated $100,000 in rebate claims that were paid in January of 2010 and deducted in ABC's December 31, 2009, tax year under the recurring item exception. Therefore, ABC properly recognized a $500,000 rebate liability deduction on ABC's December 31, 2009, tax return.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, an item must be allocated in a reasonably accurate manner if any portion of the item is deducted under the recurring item exception. Therefore, ABC will be required to allocate its entire $500,000 rebate liability deduction in a reasonably accurate manner as defined in paragraph (f)(2)(iii) of this section.

(3) *Special rules*—(i) *Advance payments*—(A) *Advance payments under §1.451–5(b)(1)(ii).* An advance payment for which the taxpayer uses the method of accounting provided in §1.451–5(b)(1)(ii) is includible in computing taxable income for an annualization period in accordance with that method of accounting except that, if §1.451–5(c) applies, any amount not included in computing taxable income by the end of the second taxable year following the year in which substantial advance payments are received, and not previously included in accordance with the taxpayer's accrual method of accounting, is includible in computing taxable income on the last day of such second taxable year.

(B) *Advance payments under Rev. Proc. 2004–34.* An advance payment for which the taxpayer uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34, 2004–1 C.B. 991, (see §601.601(d)(2)(ii)(*b*) of this chapter) is includible in computing taxable income for an annualization period in accordance with that method of accounting, except that any amount not included in computing taxable income by the end of the taxable year succeeding the taxable year of receipt is includible in computing taxable income on the last day of such succeeding taxable year.

(ii) *Extraordinary items*—(A) *In general.* In general, extraordinary items must be taken into account after annualizing the taxable income for the annualization period. For purposes of the preceding sentence an extraordinary item is any item identified in §1.1502–76(b)(2)(ii)(C)(*1*), (*2*), (*3*), (*4*), (*7*), and (*8*), a net operating loss carryover, a section 481(a) adjustment, net gain or loss from the disposition of 25 percent or more of the fair market value of a taxpayer's business assets during a taxable year, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).

(B) *De minimis extraordinary items.* A taxpayer may treat any *de minimis* extraordinary item, other than a net operating loss carryover or section 481(a) adjustment, as an item under the general rule of paragraph (f)(1) of this section rather than an extraordinary item as provided for in paragraph (f)(3)(ii) of this section. A *de minimis* extraordinary item is any item identified in paragraph (f)(3)(ii)(A) of this section resulting from a transaction in which the total extraordinary items resulting from such transaction is less than $1,000,000.

(C) *Special rule for net operating loss deductions and section 481(a) adjustments.* For purposes of paragraph (f)(3)(ii) of this section, a taxpayer must treat a net operating loss deduction and section 481(a) adjustment as extraordinary items arising on the first day of the tax year in which the item is taken into account in determining taxable income. Notwithstanding the preceding sentence, a taxpayer may choose to treat the portion of a section 481(a) adjustment recognized during the tax year of the accounting method change as an extraordinary item arising on the date the Form 3115, *"Application for Change in Accounting Method,"* requesting the change was filed with the national office of the Internal Revenue Service.

(iii) *Credits*—(A) *Current year credits.* With respect to a current year credit, the items upon which the credit is computed are annualized, the amount of the credit is computed based on the annualized items, and the amount of the credit is deducted from the annualized tax. For example, for an annualization period consisting of three months in a full 12-month taxable year, the items upon which the credit is based that are taken into account for the three month period are multiplied by four, the credit is determined based on the annualized amount of the items, and the credit reduces the annualized tax.

(B) *Credit carryovers.* Any credit carryover to the current taxable year is taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period and computing the applicable tax, and before applying the applicable percentage.

(iv) *Depreciation and amortization*—(A) *Estimated annual depreciation and amortization.* In general, in determining taxable income for any annualization period, a proportionate amount of the taxpayer's estimated annual depreciation and amortization (depreciation) expense may be taken into account. For purposes of the preceding sentence, estimated annual depreciation expense is the estimated depreciation expense to be properly taken into account in determining the taxpayer's taxable income for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, additional first-year depreciation and expense deductions and section 179 or any similar provision, and other events that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year.

(B) *Safe harbors*—(*1*) *Proportionate depreciation allowance.* In determin-

ing taxable income for any annualization period, in lieu of the rule provided in paragraph (f)(3)(iv)(A) of this section a taxpayer may take into account a proportionate amount of the depreciation and amortization (depreciation) expense, including special depreciation and expense deductions such as those provided for in section 168(k) and section 179 or any similar provision, allowed for the taxable year from—

(*i*) Assets that were in service on the last day of the prior taxable year, are in service on the first day of the current taxable year, and that have not been disposed of during the annualization period;

(*ii*) Assets placed in service during the annualization period and have not been disposed of during that period; and

(*iii*) Assets that were in service on the last day of the prior taxable year and that are disposed of during the annualization period.

(*2*) *90 percent of preceding year's depreciation.* In determining taxable income for any annualization period, in lieu of the general rule provided in paragraph (f)(3)(iv)(A) of this section, a proportionate amount of 90 percent of the amount of depreciation and amortization (depreciation) expense taken on the taxpayer's Federal income tax return for the preceding taxable year may be taken into account. If the taxpayer's preceding taxable year is less than 12 months (a short taxable year), the amount of depreciation expense taken into account is annualized by multiplying the depreciation and amortization for the short taxable year by 12, and dividing the result by the number of months in the short taxable year.

(*3*) *Safe harbor operational rules.* If a taxpayer selects one of the two safe harbors provided in paragraph (f)(3)(iv)(B)(*1*) or paragraph (f)(3)(iv)(B)(*2*) of this section, the taxpayer must use that safe harbor for all depreciation expenses within the annualization period for the annualized income installment. However, a taxpayer may use either the method provided for in paragraph (f)(3)(iv)(A) of this section or a method provided for in this paragraph (f)(3)(iv)(B) of this section for each annualized income installment during the taxable year. For example, a taxpayer may use the safe harbor provided in paragraph (f)(3)(iv)(B)(*1*) of this section for its first annualized income installment and may use the general rule provided in paragraph (f)(3)(iv)(A) of this section for its second annualized income installment.

(C) *Short taxable years.* If the taxable year is, or will be, a short taxable year (based on all relevant information available as of the last day of the annualization period), annual depreciation expense is computed using the rules applicable for computing depreciation during a short taxable year for purposes of determining the annual depreciation expense to be allocated to an annualization period. For this purpose, the rules applicable for computing depreciation during a short taxable year are applied on the basis of the date the taxable year is expected to end based on all relevant information available as of the last day of the annualization period. See Rev. Proc. 89–15, 1989–1 C.B. 816, for computing depreciation expense under section 168 (see §601.601(d)(2)(ii)(*b*) of this chapter). An annualization period is not treated as a short taxable year for purposes of determining the depreciation expense for an annualization period. See paragraph (c)(3) of this section.

(v) *Distributive share of items*—(A) *Member of partnership.* In determining a partner's distributive share of partnership items that must be taken into account during an annualization period, the rules set forth in §1.6654–2(d)(2) are applicable.

(B) *Treatment of subpart F income and income under section 936(h)*—(*1*) *General rule.* Any amounts required to be included in gross income under section 936(h) or section 951(a), and credits properly allocable thereto, are taken into account in computing any annualized income installment in a manner similar to the manner under which partnership inclusions, and credits properly allocable thereto, are taken into account in accordance with paragraph (f)(3)(v)(A) of this section.

(*2*) *Prior year safe harbor*—(*i*) *General rule.* If a taxpayer elects to have the safe harbor in this paragraph (f)(3)(v)(B)(*2*) apply for any taxable year, then paragraph (f)(3)(v)(B)(*1*) of this section does not apply; and, for purposes of computing any annualized income installment for the taxable year, the taxpayer is treated as having received ratably during the taxable year items of income and credit described in paragraph (f)(3)(v)(B)(*1*) of this section in an amount equal to 115 percent of the amount of such items shown on the return of the taxpayer for the preceding taxable year (the second preceding taxable year in the case of the first and second required installments for such taxable year).

(*ii*) *Special rule for noncontrolling shareholder.* If a taxpayer making the election under paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is a noncontrolling shareholder of a corporation, paragraph (f)(3)(v)(B)(*2*)(*i*) of this section is applied with respect to items of such corporation by substituting "100 percent" for "115 percent". For purposes of paragraph (f)(3)(v)(B)(*2*)(*ii*) of this section, the term *noncontrolling shareholder* means, with respect to any corporation, a shareholder that, as of the beginning of the taxable year for which the installment is being made, does not own within the meaning of section 958(a), and is not treated as owning within the meaning of section 958(b), more than 50 percent by vote or value of the stock in the corporation.

(C) *Dividends from closely held real estate investment trust*—(*1*) *General rule.* Any dividend received from a closely held real estate investment trust by any person that owns, after the application of section 856(d)(5), 10 percent or more by vote or value of the stock or beneficial interests in the trust is taken into account in computing annualized income installments in a manner similar to the manner under which partnership income inclusions are taken into account.

(*2*) *Closely held real estate investment trust.* For purposes of paragraph (f)(3)(v)(C)(*1*) of this section, the term *closely held real estate investment trust* means a real estate investment trust with respect to which 5 or fewer persons own, after the application of section 856(d)(5), 50 percent or more by vote or value of the stock or beneficial interests in the trust.

(D) *Other passthrough entities.* A taxpayer's distributive share of items from a passthrough entity, other than those described in paragraphs (f)(3)(v)(A) and (f)(3)(v)(C) of this section, is taken into account in computing any annualized income installment in a manner similar to the manner under which partnership items are taken into account under paragraph (f)(3)(v)(A) of this section.

(vi) *Alternative minimum taxable income exemption amount.* The alternative minimum taxable income exemption amount provided by section 55(d)(2) is

applied after the alternative minimum taxable income for the annualization period is annualized.

(vii) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples. Unless otherwise stated, the following examples assume that the taxpayer uses the 3–3-6–9 annualization period.

Example 1. Expense paid or incurred in the installment period. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has licensed technology from Corporation XYZ. Pursuant to the license agreement, ABC pays a license fee to XYZ equal to $.01 for every dollar of gross receipts earned by ABC. For 2008, ABC projects gross receipts of $200,000,000, of which $100,000,000 is earned by March 31, 2008. Pursuant to paragraph (f)(1) of this section, a license fee expense of $1,000,000 ($100,000,000 X $.01) is incurred by March 31, 2008, and may be taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 2. Expense not paid or incurred in the installment period. Same facts as *Example 1* except that ABC does not earn any gross receipts by March 31, 2008. In accordance with paragraph (f)(1) of this section, because the license fee expense was not incurred under §1.461–1(a)(2) by the last day of the annualization period, no license fee expense is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year.

Example 3. Bad debt expense. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. As of December 31, 2007, ABC had a $100,000 account receivable due from XYZ related to the sale of goods from ABC to XYZ during 2007. On March 30, 2008, ABC determined that its receivable from XYZ was worthless under section 166 and the regulations. No other receivables were determined to be worthless between January 1, 2008, and March 31, 2008. In accordance with paragraph (f)(1) of this section, a $100,000 bad debt write-off is taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment.

Example 4. Bad debt expense. Same facts as *Example 3* except that ABC determines that the receivable from XYZ was worthless under section 166 and the regulations on April 10, 2008. As of March 31, 2008, ABC had not determined that any receivables were worthless under section 166 and the regulations. In accordance with paragraph (f)(1) of this section, the $100,000 bad debt expense attributable to the receivable from XYZ is not taken into account for purposes of determining the taxable income to be annualized in computing ABC's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because the receivable from XYZ became worthless after the last day of the annualization period.

Example 5. Employer deductions under section 404 and 419. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On March 1, 2008, the board of directors of ABC makes a binding, irrevocable commitment to fund a minimum contribution of $10,000,000 to ABC's qualified retirement plan by March 14, 2009. ABC remits a $1,000,000 payment to the retirement plan on March 1, 2008, and a $9,000,000 payment on March 3, 2009. ABC does not incur any other related retirement plan deductions during its 2008 taxable year.

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's employer deduction for payment made to the qualified plan must be allocated throughout the tax year for estimated tax purposes in a reasonably accurate manner. Therefore, ABC will not be permitted to allocate the $10,000,000 deduction to its first installment period. Under paragraph (f)(2)(iii) of this section, ABC's qualified plan deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $2,500,000 of its qualified plan deduction in its first installment period.

Example 6. Prepaid expense. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and does not capitalize qualifying costs under the exception provided for in §1.263(a)–4(f). ABC uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On July 1, 2008, ABC purchases an annual business license from State X which permits ABC to operate its business in State X from July 1, 2008, through June 30, 2009. An annual payment of $12,000 is due on July 1, 2008, and ABC pays the fee on this date. ABC has not elected out of the 12-month rule provided by §1.263(a)–4(f) and therefore ABC is not required to capitalize any amount paid for the license and will recognize a $12,000 deduction for the tax year ending December 31, 2008, with respect to this license.

(ii) Under the rule provided in paragraph (f)(2)(ii) of this section, ABC's $12,000 business license expense must be allocated in a reasonably accurate manner because ABC utilizes the 12-month rule exception provided for in the §1.263(a)–4(f). Under paragraph (f)(2)(iii) of this section, ABC's deduction will be deemed to be allocated in a reasonably accurate manner if the item is allocated ratably throughout the taxable year. Therefore, ABC will be permitted to allocate $3,000 of its business license deduction in its first installment period.

Example 7. Real property tax liability. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC owns real property in State Y and uses the real property in its trade or business. ABC incurs a $400,000 deduction for State Y real estate taxes during ABC's December 31, 2008, taxable year. ABC has elected to recognize its real property taxes ratably under section 461(c).

(ii) Under the rule provided in paragraph (f)(2)(i) of this section, ABC's $400,000 real property tax liabilities must be allocated in a reasonably accurate manner. However, paragraph (f)(2)(iv) of this section provides that with respect to real property taxes for which an election has been made under section 461(c), ratable accrual is the only method which will be considered a reasonably accurate method. Therefore, ABC will be required to allocate its $400,000 real property taxes ratably for estimated tax purposes and thus $100,000 will be allocated to the ABC's first annualized income installment.

Example 8. NOL (Net Operating Loss) deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC has a net operating loss carryover to 2008 of $2,000,000. ABC's taxable income from January 1, 2008, through March 31, 2008, without regard to any net operating loss deduction, is $1,500,000 (pre-NOL taxable income). Under the special rule for net operating loss deductions provided in paragraph (f)(3)(ii) of this section, the NOL deduction is treated as an extraordinary item incurred on the first day of ABC's December 31, 2008, tax year. Therefore, the NOL deduction is taken into account after annualization for purposes of determining ABC's first annualized income installment.

Example 9. Advance payment. (i) Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 and 2009 taxable years. ABC is in the business of giving dancing lessons and receives advance payments. For Federal income tax purposes, ABC uses the Deferral Method provided in section 5.02 of Rev. Proc. 2004–34 for the advance payments it receives for dance lessons. On November 1, 2008, ABC receives an advance payment of $2,400 for a 2-year contract commencing on November 1, 2008, and providing for up to 24 individual, 1-hour lessons. ABC provides 2 lessons in 2008, 12 lessons in 2009, and 10 lessons in 2010. ABC recognizes $200 in revenues in its financial statements for the last quarter of 2008. ABC recognizes $300 in revenues in its financial statements for each quarter of 2009 for a total of $1,200 in 2009. ABC recognizes the remaining $1,000 in revenues in its financial statements during 2010. For tax purposes, ABC recognizes $200 into revenue in 2008 and $2,200 into revenue in 2009 under Rev. Proc. 2004–34. See §601.601(d)(2)(ii)(*b*).

(ii) Pursuant to paragraph (f)(3)(i)(B) of this section, ABC is not required to take into account any of the advance payment for purposes of computing any required installment payment for ABC's 2008 taxable year because no part of the $2,400 advance payment was recognized as income in ABC's financial statements during the first nine months of ABC's 2008 taxable year. In 2009, ABC must take into account $300 of revenue for purposes of computing its first and second required installment payments, $600 of revenue for purposes of computing its third required installment payment and $900 for purposes of computing its fourth required installment payment. Pur-

suant to paragraph (f)(3)(i)(B) of this section, the remaining deferred revenue is recognized on December 31, 2009, for purposes of computing ABC's annualized income installments for 2009.

Example 10. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On December 20, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a negative section 481(a) adjustment of $80,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, the negative $80,000 section 481(a) adjustment is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section ABC is permitted to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or December 20, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the negative $80,000 section 481(a) adjustment as an extraordinary item occurring in January 1, 2008. Accordingly, $80,000 of the negative section 481(a) adjustment is taken into account after annualization for purposes of determining ABC's first annualized income installment. In addition, under §1.6655–6(b), ABC is required to use its new method of accounting as of January 1, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting in determining taxable income to be annualized in computing ABC's first annualized income installment.

Example 11. Section 481(a) adjustment. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting. The requested change results in a positive section 481(a) adjustment of $240,000. ABC subsequently receives the consent of the Commissioner to make the change and therefore, $60,000 of the section 481(a) adjustment (one quarter of the positive $240,000 section 481(a) adjustment) is properly recognized in ABC's tax return for the year ending December 31, 2008. Under paragraph (f)(3)(ii) of this section, ABC is permitted to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on January 1, 2008 (the first day of ABC's December 31, 2008, tax year), or June 15, 2008 (the date ABC filed the Form 3115). ABC chooses to recognize the positive $60,000 section 481(a) adjustment as an extraordinary item occurring on June 15, 2008. Accordingly, the $60,000 positive section 481(a) adjustment is not taken into account for purposes of determining ABC's first annualized income installment. However, in all futures years any portion of the section 481(a) adjustment related to this change in method of accounting will be treated as an extraordinary item occurring on the first day of the tax year under paragraph (f)(3)(ii) of this section. In addition, under §1.6655–6(b), ABC is required to use its new method of accounting as of June 15, 2008 for estimated tax purposes, consistent with the recognition of the section 481(a) adjustment for estimated tax purposes. Therefore, ABC will be required to use the new method of accounting (as of the beginning of the tax year) for purposes of determining taxable income to be annualized in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include June 15, 2008.)

Example 12. Extraordinary item. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On May 10, 2008, ABC reaches a settlement agreement with XYZ over a tort action filed by ABC. As a result, ABC receives a payment of $10,000,000 on June 15, 2006, that is recognized as income by ABC. The settlement of a tort action is an extraordinary item defined in paragraph (f)(3)(ii)(A) of this section. Accordingly, the $10,000,000 of income will be taken into account by ABC on May 10, 2008, for purposes of computing ABC's annualized income installments for 2008. Therefore, the $10,000,000 settlement will only be taken into account in computing ABC's third and fourth annualized income installments (which are based upon annualization periods that include May 10, 2008.) In addition, the $10,000,000 settlement income will be taken into account as an extraordinary item of income after annualization for purposes of determining ABC's third and fourth annualized installment payments.

Example 13. Credit carryover. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $1,500,000 before reduction for any credits. ABC has an unused section 38 credit from 2007 for increasing research activities from 2007 of $500,000 that is carried over to 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $1,000,000, determined as the tax for the taxable year computed by placing on an annualized basis ABC's taxable income from its first annualization period from January 1, 2008, through March 31, 2008 ($1,500,000) reduced by the $500,000 credit carryover from 2007. Therefore, ABC's first required installment payment for 2008 is $250,000 ($1,000,000 x 25%).

Example 14. Current year credit. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC projects its annualized tax for its 2008 taxable year, based on annualizing ABC's taxable income for its first annualization period from January 1, 2008, through March 31, 2008, to be $2,000,000 before reduction for any credits. ABC has historically earned a section 41 credit for increasing research activities and, for 2008, ABC estimates that it will earn a credit for increasing research activities under section 41 of $1,200,000. However, pursuant to paragraph (f)(3)(iii) of this section, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate a credit of $1,600,000 for 2008. For purposes of determining ABC's first annualized income installment, ABC's annualized tax for 2008 is $400,000, determined as the tax for the 2008 taxable year ($2,000,000) computed by placing on an annualized basis ABC's taxable income from its first annualization period January 1, 2008, through March 31, 2008, reduced by a $1,600,000 current year section 41 credit from increasing research activities. Therefore, ABC's first required installment payment for 2008 is $100,000 ($400,000 x 25%).

Example 15. Current year credit. Same facts as *Example 14* except that ABC does not begin any research activities until April 3, 2008, and will not incur any research expenses described in paragraph (f)(1)(ii) of this section. As a result, if ABC were to annualize all components involved in computing the current year credit based on ABC's activity from January 1, 2008, through March 31, 2008, ABC would generate no section 41 research credit for purposes of determining its first annualized income installment. Pursuant to paragraph (f)(3)(iii) of this section, ABC cannot take into account any credit for its first annualization period because ABC did not incur any qualified research expenses by the last day of the first annualization period. Accordingly, for purposes of determining ABC's first annualized income installment, ABC's annualized tax for its first annualization period January 1, 2008, through March 31, 2008, is $2,000,000. Therefore, ABC's first required installment payment for 2008 is $500,000 ($2,000,000 x 25%).

Example 16. Depreciation and amortization expense. Corporation ABC, a calendar year taxpayer that began business on January 2, 2007, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. On January 2, 2007, ABC purchased and placed in service a tangible depreciable asset that costs $50,000 and is 5-year property under section 168(e). ABC depreciates its 5-year property placed in service in 2007 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half year convention. On January 2, 2008, ABC purchased and placed in service qualified Gulf Opportunity Zone property (GO Zone property) that costs $30,000 and is 5-year property under section 168(e). ABC will depreciate its 5-year property placed in service in 2008 under the general depreciation system using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. ABC will deduct the 50% additional first year depreciation deduction under section 1400N(d) with respect to the GO Zone property. For tax year 2007, ABC takes a depreciation deduction under section 168 of $10,000 ($50,000 X 20% = $10,000). ABC does not anticipate being subject to the mid-quarter convention for the 2008 taxable year, does not anticipate making any depreciation elections for any class of property, does not anticipate making a section 179 election, does not anticipate any sales

or other dispositions of depreciable property, and no events have occurred, nor does ABC know, based on all relevant information available as of the due date of ABC's first required installment for 2008, of any event that will occur to cause ABC's 2008 taxable year to be a short taxable year. The optional amounts of depreciation expense ABC may take into account for its first annualized income installment for its 2008 taxable year are determined as follows:

(i) *General rule — Estimated annual depreciation.* In accordance with the general rule provided in paragraph (f)(3)(iv)(A) of this section, ABC may take a depreciation expense of $8,500 ($34,000 X 3/12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. ABC's estimated annual depreciation expense for 2008 of $34,000 is computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 X 50% = $15,000) plus annual depreciation of $16,000 ($40,000 X 40% = $16,000) and $3,000 ($15,000 X 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(ii) *Safe Harbor — Proportionate depreciation allowance.* In accordance with the safe harbor provided in paragraph (f)(3)(iv)(B)(*1*) of this section, ABC may take a depreciation expense of $8,500 ($34,000 X 3/12 = $8,500) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income based on annual depreciation expense for 2008 of $34,000, computed as follows: $15,000 for the 50% additional first year depreciation deduction under section 1400N(d) ($30,000 X 50% = $15,000) plus annual depreciation of $16,000 ($40,000 X 40% = $16,000) and $3,000 ($15,000 X 20% = $3,000). Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(iii) *Safe Harbor — 90 percent of preceding year's depreciation.* In accordance with the safe harbor in paragraph (f)(3)(iv)(B)(*2*) of this section, ABC may take a depreciation expense of $2,250 ($10,000 prior year's depreciation X 90% = $9,000 X 3/12 = $2,250) into account in computing ABC's January 1, 2008, through March 31, 2008, taxable income. Under paragraphs (c)(3) and (f)(3)(iv)(C) of this section, ABC may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

(g) *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*—(1) *In general.* In determining the applicability of the annualization exceptions described in paragraphs (a) and (b) of this section and §1.6655–3, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date. This paragraph (g) applies only to the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, adjustments required under section 263A, the computation of a taxpayer's section 199 deduction, intercompany adjustments for taxpayers that file consolidated returns, the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year, deferred gain on a qualifying conversion or exchange of property under sections 1031 and 1033 that the taxpayer reasonably believes will be replaced with qualifying replacement property, and any other item designated by the Secretary by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter).

(2) *Example.* The following example illustrates the rules of this paragraph (g):

Example. Section 199 deduction. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2008 taxable year. ABC engages in production activities that generate qualified production activities income (QPAI), as defined in §1.199–1(c), and projects taxable income of $50,000 for its first annualization period from January 1, 2008, through March 31, 2008, without taking into account the section 199 deduction. During its first annualization period from January 1, 2008, through March 31, 2008, ABC incurs W–2 wages allocable to domestic production gross receipts pursuant to section 199(b)(2) of $10,000. Pursuant to paragraph (g)(1) of this section, ABC is permitted to take into account its estimated section 199 deduction before annualizing taxable income based on the lesser of its estimated QPAI or taxable income and W–2 wages for its first installment period for 2008. For the first installment period in 2008, ABC is permitted to recognize a deduction under section 199 of $3,000 ($50,000 x .06 = $3,000) subject to the wage limitation of $5,000 (50 percent of $10,000 of W–2 wages incurred during the first installment period). Accordingly, ABC's annualized income for the first installment for 2008 is $188,000 (($50,000 - $3,000) x 12/3 = $188,000). The tax on $188,000 is $56,570 and ABC's first required installment for 2008 is $14,143 ($56,570 x .25 = $14,143).

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

Par. 8a. Section 1.6655–3 is revised to read as follows:

§1.6655–3 Adjusted seasonal installment method.

(a) *In general.* In the case of any required installment, the amount of the adjusted seasonal installment is the excess (if any) of—

(1) 100 percent of the amount determined under paragraph (c) of this section; over

(2) The aggregate amount of all prior required installments for the taxable year.

(b) *Limitation on application of section.* This section applies only if the base period percentage (as defined in section 6655(e)(3)(D)(i) and paragraph (d)(1) of this section) for any six consecutive months of the taxable year equals or exceeds seventy percent.

(c) *Determination of amount.* The amount determined under this paragraph (c) for any installment will be determined in the following manner—

(1) Take the taxable income for all months during the taxable year preceding the filing month;

(2) Divide such amount by the base period percentage for all months during the taxable year preceding the filing month;

(3) Determine the tax on the amount determined under paragraph (c)(2) of this section; and

(4) Multiply the tax computed under paragraph (c)(3) of this section by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

(d) *Special rules*—(1) *Base period percentage.* The base period percentage for any period of months is the average percent that the taxable income for the corresponding months in each of the three preceding taxable years bears to the taxable income for the three preceding taxable years. If there is no taxable income for the corresponding months, taxable income for this purpose is zero.

(2) *Filing month.* The term *filing month* means the month in which the installment is required to be paid.

(3) *Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.* The rules governing the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the annualized income installment method under §1.6655–2 apply to the computation of taxable income (and resulting tax) for purposes of determining any required installment payment

of estimated tax under the adjusted seasonal installment method.

(4) *Alternative minimum tax.* The amount determined under paragraph (c) of this section must properly take into account the amount of any alternative minimum tax under section 55 that would apply for the period of the computation. The amount of any alternative minimum tax that would apply is determined by applying to alternative minimum taxable income, tentative minimum tax, and alternative minimum tax, the rules described in paragraph (c) of this section for taxable income and tax.

(e) *Example.* The provisions of this section may be illustrated by the following example:

Example. (i) X, a corporation that reports on a calendar year basis, expects to have an estimated tax liability of $1,200,000 for its taxable year ending December 31, 2009. On its 2008 tax return, X reports a tax liability of $652,800. X pays four installments of estimated tax, each in the amount of $250,000, $250,000, $250,000, and $450,000 on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively. X reports a tax liability of $1,152,600 on its return due March 15, 2010, with no credits against tax. Under the general provision of section 6655(b) and section 6655(d), there was an underpayment in the amount of $76,300 for the second installment through September 15, 2009, and $114,450 for the third installment through December 15, 2009, determined as follows:

(A) Tax as defined in section 6655(g) =	$1,152,600
(B) 100% of this paragraph (e), *Example* (i)(A) =	$1,152,600
(C) Amount of estimated tax required to be paid on or before the first installment (25% of $652,800) =	$ 163,200
(D) Deduction of amount timely paid on or before the first installment due date under the general rule of section 6655(b) =	$ 250,000
(E) Amount of overpaid estimated tax for the first installment date =	$ 86,800
(F) Amount of estimated tax required to be paid on or before the second installment (25% of $1,152,600 plus the recapture amount under section 6655(d)(2)(B) of $124,950 (25% of $1,152,600 less $163,200)) =	$ 413,100
(G) Deduction of amount paid on or before the due date of the second installment less amount applied towards the first installment under the general rule of section 6655(b) ($250,000 paid in each of the first and second installments less this paragraph (e), *Example* (i)(C)) =	$ 336,800
(H) Amount of underpayment for the second installment date =	$ 76,300
(I) Amount of estimated tax required to be paid on or before the third installment (25% of $1,152,600) =	$ 288,150
(J) Deduction of amount paid on or before the due date of the third installment less amount applied towards the first and second installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F)) =	$ 173,700
(K) Amount of underpayment for the third installment date =	$ 114,450
(L) Amount of estimated tax required to be paid on or before the fourth installment (25% of $1,152,600) =	$ 288,150
(M) Deduction of amount paid on or before the due date of the fourth installment less amount applied towards the first, second, and third installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments plus $450,000 paid in the fourth installment less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F) less this paragraph (e), *Example* (i)(I)) =	$ 335,550
(N) Amount of overpaid estimated tax for the fourth installment date =	$ 47,400

(ii) X wants to determine if it qualifies for the adjusted seasonal installment method. X determines that its monthly taxable income for the preceding three taxable years and for the current taxable year 2009 is as follows:

January	*February*	*March*	*April*	*May*	*June*
2006					
$100,000	$ 90,000	$ 80,000	$ 70,000	$ 60,000	$ 20,000
2007					
$200,000	$170,000	$170,000	$130,000	$125,000	$ 45,000
2008					
$410,000	$350,000	$330,000	$270,000	$240,000	$ 80,000
2009					
$600,000	$680,000	$650,000	$560,000	$460,000	$170,000

July	August	September	October	November	December
2006					
$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
2007					
$21,000	$19,000	$20,000	$20,000	$20,000	$20,000
2008					
$40,000	$40,000	$40,000	$40,000	$40,000	$40,000
2009					
$70,000	$60,000	$50,000	$40,000	$30,000	$20,000

(iii) X must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (see section 6655(e)(3) and paragraphs (b) and (c) of this section). By using its taxable income for the first 6 months of 2006, 2007, and 2008, X qualifies for the adjusted seasonal installment method because its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(A) Taxable income for first 6 months of 2006 =	$ 420,000
(B) Total taxable income for 2006 =	$ 480,000
(C) Divide this paragraph (e), *Example* (iii)(A) by this paragraph (e), *Example* (iii)(B) =	.875
(D) Taxable income for first 6 months of 2007 =	$ 840,000
(E) Total taxable income for 2007 =	$ 960,000
(F) Divide this paragraph (e), *Example* (iii)(D) by this paragraph (e), *Example* (iii)(E) =	.875
(G) Taxable income for first 6 months of 2008 =	$1,680,000
(H) Total taxable income for 2008 =	$1,920,000
(I) Divide this paragraph (e), *Example* (iii)(G) by this paragraph (e), *Example* (iii)(H) =	.875
(J) Add this paragraph (e), *Example* (iii)(C), (F), and (I) =	2.625
(K) Divide this paragraph (e), *Example* (iii)(J) by 3 =	.875

(iv) To determine the amount of the first installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 3 months of 2009 =	$1,930,000
(B) Taxable income for first 3 months of 2006 ($270,000) divided by total taxable income for 2006 ($480,000) =	.5625
(C) Taxable income for first 3 months of 2007 ($540,000) divided by total taxable income for 2007 ($960,000) =	.5625
(D) Taxable income for first 3 months of 2008 ($1,090,000) divided by total taxable income for 2008 ($1,920,000) =	.5677
(E) Add this paragraph (e), *Example* (iv)(B), (C), and (D) and divide by 3 =	.5642
(F) Divide this paragraph (e), *Example* (iv)(A) by this paragraph (e), *Example* (iv)(E) =	$3,420,773
(G) Determine the tax on this paragraph (e), *Example* (iv)(F) =	$1,163,049
(H) Taxable income for first 4 months of 2006 ($340,000) divided by total taxable income for 2006 ($480,000) =	.7083
(I) Taxable income for first 4 months of 2007 ($670,000) divided by total taxable income for 2007 ($960,000) =	.6979
(J) Taxable income for first 4 months of 2008 ($1,360,000) divided by total taxable income for 2008 (1,920,000) =	.7083
(K) Add this paragraph (e), *Example* (iv)(H), (I), and (J) and divide by 3 =	.7048
(L) Multiply this paragraph (e), *Example* (iv)(G) by this paragraph (e), *Example* (iv)(K) =	$ 819,717

(M) 100% of this paragraph (e), *Example* (iv)(L) =	$ 819,717
(N) Amount of all prior required installments for 2009 =	$0
(O) Amount of adjusted seasonal installment for the first installment payment (this paragraph (e), *Example* (iv)(M) less this paragraph (e), *Example* (iv)(N)) =	$ 819,717

(v) To determine the amount of the second installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 5 months of 2009 =	$2,950,000
(B) Taxable income for first 5 months of 2006 ($400,000) divided by total taxable income for 2006 ($480,000) =	.8333
(C) Taxable income for first 5 months of 2007 ($795,000) divided by total taxable income for 2007 ($960,000) =	.8281
(D) Taxable income for first 5 months of 2008 ($1,600,000) divided by total taxable income for 2008 ($1,920,000) =	.8333
(E) Add this paragraph (e), *Example* (v)(B), (C), and (D) and divide by 3 =	.8316
(F) Divide this paragraph (e), *Example* (v)(A) by this paragraph (e), *Example* (v)(E) =	$3,547,379
(G) Determine the tax on this paragraph (e), *Example* (v)(F) =	$1,206,109
(H) Taxable income for first 6 months of 2006 ($420,000) divided by total taxable income for 2006 ($480,000) =	.875
(I) Taxable income for first 6 months of 2007 ($840,000) divided by total taxable income for 2007 ($960,000) =	.875
(J) Taxable income for first 6 months of 2008 ($1,680,000) divided by total taxable income for 2008 ($1,920,000) =	.875
(K) Add this paragraph (e), *Example* (v)(H), (I), and (J) and divide by 3 =	.875
(L) Multiply this paragraph (e), *Example* (v)(G) by this paragraph (e), *Example* (v)(K) =	$1,055,345
(M) 100% of this paragraph (e), *Example* (v)(L) =	$1,055,345
(N) Amount of all prior required installments for 2009 =	$ 163,200
(O) Amount of adjusted seasonal installment for the second installment payment (this paragraph (e), *Example* (v)(M) less this paragraph (e), *Example* (v)(N)) =	$ 892,145

(vi) To determine the amount of the third installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 8 months of 2009 =	$3,250,000
(B) Taxable income for first 8 months of 2006 ($440,000) divided by total taxable income for 2006 ($480,000) =	.9167
(C) Taxable income for first 8 months of 2007 ($880,000) divided by total taxable income for 2007 ($960,000) =	.9167
(D) Taxable income for first 8 months of 2008 ($1,760,000) divided by total taxable income for 2008 ($1,920,000) =	.9167
(E) Add this paragraph (e), *Example* (vi)(B), (C), and (D) and divide by 3 =	.9167
(F) Divide this paragraph (e), *Example* (vi)(A) by this paragraph (e), *Example* (vi)(E) =	$3,545,326
(G) Determine the tax on this paragraph (e), *Example* (vi)(F) =	$1,205,411
(H) Taxable income for first 9 months of 2006 ($450,000) divided by total taxable income for 2006 ($480,000) =	.9375
(I) Taxable income for first 9 months of 2007 ($900,000) divided by total taxable income for 2007 ($960,000) =	.9375

(J) Taxable income for first 9 months of 2008 ($1,800,000) divided by total taxable income for 2008 ($1,920,000) =	.9375
(K) Add this paragraph (e), *Example* (vi)(H), (I), and (J) and divide by 3 =	.9375
(L) Multiply this paragraph (e), *Example* (vi)(G) by this paragraph (e), *Example* (vi)(K) =	$1,130,073
(M) 100% of this paragraph (e), *Example* (vi)(L) =	$1,130,073
(N) Amount of all prior required installments for 2009 =	$ 576,300
(O) Amount of adjusted seasonal installment for the third installment payment (this paragraph (e), *Example* (vi)(M) less this paragraph (e), *Example* (vi)(N)) =	$ 553,773

(vii) To determine the amount of the fourth installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 11 months of 2009 =	$3,370,000
(B) Taxable income for first 11 months of 2006 ($470,000) divided by total taxable income for 2006 ($480,000) =	.9792
(C) Taxable income for first 11 months of 2007 ($940,000) divided by total taxable income for 2007 ($960,000) =	.9792
(D) Taxable income for first 11 months of 2008 ($1,880,000) divided by total taxable income for 2008 ($1,920,000) =	.9792
(E) Add this paragraph (e), *Example* (vii)(B), (C), and (D) and divide by 3 =	.9792
(F) Divide this paragraph (e), *Example* (vii)(A) by this paragraph (e), *Example* (vii)(E) =	$3,441,585
(G) Determine the tax on this paragraph (e), *Example* (vii)(F) =	$1,170,139
(H) Taxable income for first 12 months of 2006 ($480,000) divided by total taxable income for 2006 ($480,000) =	1.0000
(I) Taxable income for first 12 months of 2007 ($960,000) divided by total taxable income for 2007 ($960,000) =	1.0000
(J) Taxable income for first 12 months of 2008 ($1,920,000) divided by total taxable income for 2008 ($1,920,000) =	1.0000
(K) Add this paragraph (e), *Example* (vii)(H), (I), and (J) and divide by 3 =	1.0000
(L) Multiply this paragraph (e), *Example* (vii)(G) by this paragraph (e), *Example* (vi)(K) =	$1,170,139
(M) 100% of this paragraph (e), *Example* (vii)(L) =	$1,170,139
(N) Amount of all prior required installments for 2009 =	$ 864,450
(O) Amount of adjusted seasonal installment for the fourth installment payment (this paragraph (e), *Example* (vii)(M) less this paragraph (e), *Example* (vii)(N)) =	$ 305,689

(viii) Because the total amount of each required estimated tax payment determined under section 6655(e)(3) and paragraph (a) of this section exceeds the amount of each required estimated tax payment determined under section 6655(d) and §1.6655–1(d) and (e), the exception described in section 6655(e) and this section does not apply and the addition to the tax with respect to the underpayment for the June 15, 2009, and September 15, 2009, installments will be imposed unless another exception (for example, see section 6655(e)(2)) applies with respect to these installments.

(f) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

Par. 9. Section 1.6655–4 is added to read as follows:

§1.6655–4 Large corporations.

(a) *Large corporation defined.* The term *large corporation* means any corporation (or a predecessor corporation) that had taxable income of at least $1,000,000 for any taxable year during the testing period. For purposes of this section, a predecessor corporation is the distributor or transferor corporation in a transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(b) *Testing period.* For purposes of paragraph (a) of this section, the term *testing period* means the 3 taxable years immediately preceding the taxable year for which estimated tax is being determined (the current taxable year) or, if less, the number of taxable years the taxpayer has been in existence.

(c) *Computation of taxable income during testing period*—(1) *Short taxable year.* In the case of a corporation (or predecessor corporation) that had a short taxable year during the testing period, for purposes of determining whether the $1,000,000 amount referred to in paragraph (a) of this section is equaled or exceeded, the taxable income for the short taxable year is computed by—

(i) Multiplying the taxable income for the short taxable year by 12; and

(ii) Dividing the resulting amount by the number of months in the short taxable year.

(2) *Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.* (i) For purposes of determining whether an acquiring corporation had taxable income of $1,000,000 or more for a taxable year in which a section 381 transaction occurs, the acquiring corporation's taxable income will be the sum of—

(A) The taxable income of the acquiring corporation for its taxable year; plus

(B) The taxable income (or loss) of the distributor or transferor corporation for that portion of its taxable year corresponding to the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)–1(b)).

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of $1,000,000 or more for a taxable year in which a section 381 transaction occurs, the distributor or transferor corporation's taxable income (or loss) is reduced by the amount of taxable income (or loss) that is included in the acquiring corporation's taxable income for the taxable year in which the distribution or transfer (as defined in §1.381(b)–1(b)) occurs, as described in paragraph (c)(2)(i)(B) of this section.

(d) *Members of controlled group*—(1) *In general.* For purposes of applying paragraph (a) of this section, the taxable income of members of a controlled group of corporations (as defined in section 1563(a)) must be aggregated for each year of the testing period. The provisions of this section do not apply to a controlled group for any taxable year in which the aggregate taxable income of the members of the controlled group is less than $1,000,000.

(2) *Aggregation.* For purposes of paragraph (d)(1) of this section, a taxable loss of any member of the controlled group for a taxable year during the testing period is not taken into account.

(3) *Allocation rule.* If the aggregate taxable income of members of a controlled group computed pursuant to paragraph (d)(1) of this section exceeds $1,000,000 during the testing period, the $1,000,000 amount that is relevant for purposes of determining, under paragraph (a)(1) of this section, whether a corporation is a large corporation is divided equally among the component members of such group (including component members excluded pursuant to paragraph (d)(2) of this section) unless all of such component members consent to an apportionment plan providing for an alternative allocation of such amount. The procedure for making and filing this plan will be the same as the procedure used for making and filing an apportionment plan under section 1561. See section 1561 and the regulations.

(4) *Controlled group members.* (i) In the case of any corporation that was a member of a controlled group of corporations at any time during the testing period but is not a member of such group during the taxable year involved, the taxable income of the former member for the testing period is determined as if such corporation were not a member of a group at any time during that period. With respect to the controlled group, the taxable income of its former member will not be taken into account in determining such group's taxable income for any taxable year during the testing period for purposes of applying paragraph (a)(1) of this section.

(ii) For purposes of paragraph (d)(4)(i) of this section, the determination of whether a corporation is a member of a controlled group during the testing period is based on whether the corporation was a member of the controlled group on the last day of the month preceding the due date of the required installment.

(e) *Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.* In determining whether a corporation (or predecessor corporation) is a large corporation for its current taxable year, items that could offset taxable income during a taxable year included in the testing period (for example, those described in sections 172 and 1212) are not to be taken into account and the taxable income of a corporation for any taxable year during the testing period is determined without regard to items carried back or carried over from any other taxable year.

(f) *Consolidated returns.* [Reserved].

(g) *Example.* The provisions of this section may be illustrated by the following example:

Example. Y Corporation and Z Corporation are calendar year taxpayers. In 2008, Z acquires all of the assets of Y in a transaction to which section 381 applies. Z's taxable income for both 2006 and 2007 was less than $1,000,000. Y's taxable income for 2008 is determined under paragraph (c)(2) of this section to be $300,000 for that portion of Y's taxable year corresponding to Z's taxable year up to and including the date of transfer. Z's taxable income for 2008 is $800,000. Under the provisions of paragraph (c)(2) of this section, Z's 2008 taxable income for purposes of determining whether it is a large corporation for taxable year 2009 is $1,100,000 ($800,000 + $300,000). Thus, Z is a large corporation for the 2009 taxable year. In addition, if Z's 2008 taxable income, as determined under paragraph (c)(2) of this section, had been less than $1,000,000 but Y's taxable income in 2006 or 2007 had been $1,000,000 or more, Z would be a large corporation for taxable year 2009 because Y is a predecessor corporation.

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§1.6655–7 [Removed]

Par. 10. Section 1.6655–7 is removed.

§1.6655–5 [Redesignated as §1.6655–7]

Par. 11. Section 1.6655–5 is redesignated as §1.6655–7.

Par. 12. Sections 1.6655–5 and 1.6655–6 are added to read as follows:

§1.6655–5 Short taxable year.

(a) *In general.* Except as otherwise provided in this section, the provisions of section 6655 and these regulations are applicable in the case of a short taxable year (including an initial taxable year) for which a payment of estimated tax is required to be made.

(b) *Exception to payment of estimated tax.* In the case of a short taxable year, no payment of estimated tax is required if—

(1) The short taxable year is a period of less than 4 full calendar months; or

(2) The tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than $500.

(c) *Installment due dates*—(1) *In general*—(i) *Taxable year of at least four months but less than twelve months.* Except as otherwise provided, in the case of a short taxable year, if such year results in a taxable year of four or more full calendar months but less than twelve full calendar months, the due dates prescribed in §1.6655–1(f)(2) apply.

(ii) *Exceptions.* (A) If the date determined under paragraph (c)(1)(i) of this section for the first required installment

due during the taxpayer's short taxable year is earlier than the 15th day of the fourth month of the taxpayer's short taxable year, the taxpayer's first required installment is due on the first due date otherwise determined under paragraph (c)(1)(i) of this section that is on or after the 15th day of the fourth month of the short taxable year.

(B) A taxpayer with an initial short taxable year may make estimated tax payments as though it were a calendar year taxpayer until it files its tax return for its initial taxable year and will not be subject to an addition to tax under section 6655 for making estimated tax payments as though it were a calendar year taxpayer for the period beginning with its initial short taxable year to the time it files its tax return for its initial short taxable year if, when filing its tax return for its initial short taxable year, the taxpayer chooses to be a fiscal year taxpayer.

(2) *Early termination of taxable year*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, if a taxable year ends early (for example, as a result of an acquisition or a change in taxable year), the due date for the final required installment is the date that would have been the due date of the next required installment if the event that gave rise to the short taxable year had not occurred.

(ii) *Exception.* If the date determined under paragraph (c)(2)(i) of this section is within thirty days of the last day of the short taxable year, the due date for the final required installment is the fifteenth day of the second month following the month that includes the last day of the short taxable year.

(d) *Amount due for required installment*—(1) *In general.* The amount due for any required installment determined under section 6655(d)(1)(B)(i) for a short taxable year is 100% of the required annual payment for the short taxable year divided by the number of required installments due (as determined under this section) for the short taxable year.

(2) *Tax shown on the return for the preceding taxable year.* If the current taxable year is a short taxable year, the amount due for any required installment determined under section 6655(d)(1)(B)(ii) is determined in the following manner—

(i) Take 100% of the tax shown on the return of the corporation for the preceding taxable year;

(ii) Multiply such amount by the number of full calendar months in the current short taxable year and divide by 12; and

(iii) Divide the amount determined under paragraph (d)(2)(ii) of this section by the number of required installments due (as determined under this section) for the current short taxable year.

(3) *Applicable percentage.* In the case of any required installment determined under section 6655(e), the applicable percentage under section 6655(e)(2)(B)(ii) is—

(i) 25%, 50%, 75%, and 100% for the first, second, third, and fourth (last) required installments, respectively, if the taxpayer will have four required installments due for the short taxable year;

(ii) 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, if the taxpayer will have three required installments due for the short taxable year;

(iii) 50% and 100% for the first and second (last) required installments, respectively, if the taxpayer will have two required installments due for the short taxable year; or

(iv) 100% for the first (and last) required installment if the taxpayer will have one required installment for the short taxable year.

(4) *Applicable percentage for installment period in which taxpayer does not reasonably expect that the taxable year will be an early termination year.* In the case of any required installment determined under section 6655(e) in which the taxpayer does not reasonably expect that the taxable year will be an early termination year, the applicable percentage under section 6655(e)(2)(B)(ii) is the applicable percentage provided by paragraph (d)(3)(i) of this section with the remaining balance of the estimated tax payment for the year due with the final installment.

(e) *Examples.* The following examples illustrate the rules of this section:

Example 1. Short year of less than 4 months. Corporation A is a calendar year taxpayer that was acquired by corporation B, a member of a consolidated group (as defined in §1.1502–1(h)) on April 16, 2009, resulting in A having a short taxable year from January 1, 2009, through April 16, 2009. Because A has a taxable year of less than four full calendar months, no estimated tax payments are required by A for the short taxable year.

Example 2. Initial short year with four required installments. Corporation B began business on January 9, 2009, and adopted a calendar year as its taxable year. B computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of B's required installments for B's initial taxable year from January 9, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 25% of the required annual payment for B's first required installment, 50% of the required annual payment for B's second required installment, 75% of the required annual payment for B's third required installment, and 100% of the required annual payment for B's fourth required installment.

Example 3. Initial short year with three required installments. Corporation C began business on February 12, 2009, and adopted a calendar year as its taxable year. C computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of C's required installments for C's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due June 15, 2009, because April 15, 2009, is earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second required installment is due September 15, 2009, and C's third (and last) installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 33.33% of the required annual payment for C's first required installment, 66.67% of the required annual payment for C's second required installment, and 100% of the required annual payment for C's third (and last) required installment.

Example 4. Initial short year with two required installments. Same facts as *Example 3* except C began business on April 10, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, C's first required installment is due September 15, 2009, because April 15, 2009, and June 15, 2009, are earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second (and last) required installment is due December 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for C's first required installment, and 100% of the required annual payment for C's second (and last) required installment.

Example 5. Initial short year for fiscal year taxpayer with two required installments. Corporation D began business on February 12, 2009, and adopted a fiscal year ending October 31 as its taxable year. D computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(ii), the due dates of D's required installments for D's initial taxable year from February 12, 2009, through October 31, 2009, are

February 15, 2009, April 15, 2009, July 15, 2009, and October 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, D's first required installment is due July 15, 2009, because February 15, 2009, and April 15, 2009, are earlier than the fifteenth day of the fourth month of D's taxable year. As a result, D's second (and last) installment is due October 15, 2009. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for D's first required installment, and 100% of the required annual payment for D's second (and last) required installment.

Example 6. Initial short year for fiscal year taxpayer with one required installment. Same facts as *Example 5* except D corporation began business on May 11, 2009. In accordance with paragraph (c)(1)(ii)(A) of this section, D's first (and last) installment is due October 15, 2009, because July 15, 2009, is earlier than the fifteenth day of the fourth month of D's taxable year. Pursuant to paragraph (d)(1) of this section, the amount due with D's required installment is 100% of the required annual payment, computed as 100% divided by the number of required installments due for the short taxable year.

Example 7. Short termination year with three required installments. Corporation E is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). E computes its 2009 required installments based on a projected 2009 total tax liability of $600,000. On July 31, 2009, E is acquired by corporation F, a member of a consolidated group (as defined in §1.1502–1(h)), resulting in E having a short taxable year from January 1, 2009, through July 31, 2009. E determines that its total tax liability for the short period is $350,000. The due dates for E's first and second required installments are April 15, 2009, and June 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), E paid $150,000 with each required installment. Pursuant to paragraph (c)(2) of this section, E's third (and last) required installment of estimated tax is due on September 15, 2009, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. Accordingly, E is required to pay $50,000 with its final required installment on September 15, 2009 ($350,000 total tax liability for the short taxable year less prior installment payments of $300,000).

Example 8. Unexpected short termination year with three required installments using the annualization method. Same facts as *Example 7* except that E uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. In addition, E does not reasonably expect until July 28, 2009, that it will have a short termination year caused by E being acquired by F on July 31, 2009. Had E known about its acquisition by F in the first quarter of 2009, E's applicable percentages for computing the amount of its three required installments would be 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(3)(ii) of this section. However, because E had an unexpected short termination year that E was not aware of until after its second required installment payment, E's applicable percentages for computing the amount of its three required installment are 25%, 50%, and 100% for the first, second, and third (last) required installments, respectively, pursuant to paragraph (d)(4) of this section.

Example 9. Short termination year ending within 30 days of the regular final installment due date. Same facts as *Example 7* except that E is acquired by F on August 31, 2009. Pursuant to paragraph (c)(2)(ii) of this section, E's third (and last) required installment of estimated tax is due on October 15, 2009, because September 15, 2009, the date that would have been the due date of E's next required installment if F's acquisition of E had not occurred, is within thirty days of the last day of E's short taxable year, and 100% of the required annual payment is due with such installment.

Example 10. Short termination year ending within 30 days of the regular final installment due date. Corporation F is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). F computes its 2009 estimated tax payments based on a projected 2009 total tax liability of $900,000. On December 3, 2009, F is acquired by corporation G, a member of a consolidated group (as defined in §1.1502–2(h)), resulting in F having a short taxable year from January 1, 2009, through December 3, 2009. F determined its total tax liability for the short period to be $800,000. The due dates for F's first, second, and third required installments are April 15, 2009, June 15, 2009, and September 15, 2009, respectively. Pursuant to section 6655(d)(1)(A), F paid $225,000 with each required installment. Pursuant to paragraph (c)(2)(ii) of this section, F's fourth (and last) required installment of estimated tax is due on February 15, 2010, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. However, because the due date for the fourth required installment falls on a legal holiday, F's required installment payment will be timely if paid on or before the first business day following the actual due date of the fourth required installment, that is, February 16, 2010. Accordingly, F is required to pay $125,000 with its final required installment on February 16, 2010 ($800,000 total tax liability for the short taxable year less prior installment payments of $675,000).

Example 11. Short termination year using the tax shown on the return for the preceding taxable year. Corporation G, a calendar year taxpayer, reported a tax liability of $75,000 on its return for the taxable year ending December 31, 2008, and is not a large corporation as defined in section 6655(g). On July 31, 2009, G makes a final distribution of its assets, in connection with a plan of complete liquidation, resulting in a short taxable year from January 1, 2009, through July 31, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii) for payments determined by reference to the tax shown on the return of the corporation for the preceding taxable year, pursuant to paragraph (d)(2) of this section, G must pay in a proportionate amount of its 2008 tax liability based on the number of months in the current taxable year. Accordingly, G must pay $43,750 ($75,000 X 7/12) through payments of estimated tax payments in 2009, with $14,583 due on April 15, 2009, June 15, 2009, and September 15, 2009.

Example 12. Short termination year using the tax shown on the return for the preceding taxable year. Same facts as *Example 11* except that G makes a final distribution of its assets, in connection with a plan of complete liquidation, on October 1, 2009, resulting in a short taxable year from January 1, 2009, through October 1, 2009. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii), G must pay $56,250 ($75,000 x 9/12) through payments of estimated tax in 2009, with $14,063 due on April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009, respectively.

Example 13. Short initial year with three required installments resulting in an underpayment. (i) Corporation H began business on February 17, 2009, and adopted a calendar year. H computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). H estimated at the beginning of its short taxable year that its estimated tax liability for short taxable year February 17, 2009, through December 31, 2009, would be $180,000. H paid its first required installment of estimated tax of $60,000 on June 15, 2009, its second required installment of estimated tax of $60,000 on September 15, 2009, and its third (and last) required installment of estimated tax of $60,000 on December 15, 2009 ($180,000 total estimated tax liability for the short taxable year less prior installment payments of $120,000). H reported a tax liability of $240,000 on its return for the short period February 17, 2009, through December 31, 2009, with no credits against tax. There was an underpayment in the amount of $20,000 on the first installment date through September 15, 2009, $40,000 on the second installment date through December 15, 2009, and $60,000 on the third (and last) installment date through March 15, 2010, determined as follows:

(A) Tax as defined in section 6655(d)(1)(B)(i) =	$240,000
(B) 100% of this paragraph (e), *Example 13* (A) =	$240,000
(C) Amount of estimated tax required to be paid by the first installment date (33.33% of $240,000) =	$ 80,000

(D) Amount of estimated tax required to be paid by the second installment date (66.67% of $240,000 less $80,000 (amount due with first installment)) =	$ 80,000
(E) Amount of estimated tax required to be paid by the third installment date (100% of $240,000 less $160,000 (amount due with first and second installment)) =	$ 80,000
(F) Deduction of amount paid on or before the first installment date =	$ 60,000
(G) Amount of underpayment for the first installment date (this paragraph (e), *Example 13* (i)(C) minus this paragraph (e), *Example 13* (i)(F)) =	$ 20,000
(H) Deduction of amount available for the second installment date ($60,000 second installment payment less this paragraph (e), *Example 13* (i)(G) applied towards the first installment underpayment) =	$ 40,000
(I) Amount of underpayment for the second installment date (this paragraph (e), *Example 13* (i)(D) minus this paragraph (e), *Example 13* (i)(H)) =	$ 40,000
(J) Deduction of amount available for the third installment date ($60,000 third installment payment less this paragraph (e), *Example 13* (i)(I) applied towards the second installment underpayment) =	$ 20,000
(K) Amount of underpayment for the third installment date (this paragraph (e), *Example 1* (i)(E) minus this paragraph (e), *Example 13* (i)(J)) =	$ 60,000

(ii) [Reserved].

(f) *52 or 53 week taxable year.* For purposes of this section, a taxable year of 52 or 53 weeks is deemed a period of 12 months in the case of a corporation that computes its taxable income in accordance with the election permitted by section 441(f).

(g) *Use of annualized income or seasonal installment method*—(1) *In general.* Regardless of the annual accounting period used by a corporation (for example, calendar year, fiscal year) the taxpayer may use the method described in §1.6655–2 (annualized income installment method) or §1.6655–3 (adjusted seasonal installment method) to compute its required installments of estimated tax when the current taxable year is a short taxable year.

(2) *Computation of annualized income installment.* To the extent a short taxable year includes an annualization period elected by the taxpayer, the taxpayer computes its annualized income installment by determining the tax on the basis of such annualized income for the annualization period, divided by 12, multiplied by the number of months in the short taxable year, and multiplied by the applicable percentage for the required installment.

(3) *Annualization period for final required installment.* For purposes of determining the final required installment (as described in paragraph (c)(2) of this section) for a short taxable year, annualized taxable income is determined by placing on an annualized basis the taxable income for the last complete annualization period that occurs within the short taxable year.

(4) *Examples.* The provisions of paragraph (g) of this section may be illustrated by the following examples:

Example 1. Corporation X began business on February 12, 2009, and adopted a calendar year as its taxable year. X adopts an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2009 taxable year. Pursuant to §1.6655–1(f)(2)(i), the due dates of X's required installments for X's initial taxable year from February 12, 2009, through December 31, 2009, are April 15, 2009, June 15, 2009, September 15, 2009, and December 15, 2009. However, in accordance with paragraph (c)(1)(ii)(A) of this section, X's first required installment is due June 15, 2009. As a result, X's second required installment is due September 15, 2009, and X's third (and last) required installment is due December 15, 2009. The amount of X's first and second required installments are each based on annualizing X's taxable income from February 12, 2009, through April 30, 2009, (the first three months of X's taxable year) and X's third (and last) required installment is based on annualizing X's taxable income from February 12, 2009, through July 31, 2009 (the first six months of X's taxable year). Because X will have three required installments due for its short taxable year, pursuant to paragraph (d)(3)(ii) of this section, the applicable percentage is 33.33% for X's first required installment, 66.67% for X's second required installment, and 100% for X's third (and last) required installment.

Example 2. (i) Y, a calendar year corporation, made a final distribution of its assets, in connection with a plan of complete liquidation, on August 3, 2009. Y filed a timely election to use the alternative annualization periods described under section 6655(e)(2)(C)(i) and determined that its taxable income for the first 2, 4 and 7 months of the taxable year was $25,000, $50,000 and $140,000. The due dates for Y's required installments for its short taxable year January 1, 2009, through August 3, 2009, are April 15, 2009, June 15, 2009, and September 15, 2009. Y made installment payments of $10,000, $10,000, and $20,000, respectively, on April 15, 2009, June 15, 2009, and September 15, 2009. The taxable income for each period is annualized as follows:

$25,000 X 12/2 =	$150,000
$50,000 X 12/4 =	$150,000
$140,000 x 12/7 =	$240,000

(ii)(A) To determine whether the first required installment equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 2-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 2 month period =	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (ii)(A)(*1*) =	$ 41,750
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (ii)(A)(*2*) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 24,354

(*4*) 100% of this paragraph (g)(4), *Example 2* (ii)(A)(*3*) =	$ 24,354
(*5*) 33.33% of this paragraph (g)(4), *Example 2* (ii)(A)(*4*) =	$ 8,117

(B) Because the total amount of estimated tax that is timely paid on or before the first installment date ($10,000) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on April 15, 2009.

(iii)(A) To determine whether the required installments made on or before June 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 4-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 4 month period =	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (iii)(A)(*1*) =	$ 41,750
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iii)(A)(2) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 24,354
(*4*) 100% of this paragraph (g)(4), *Example 2* (iii)(A)(*3*) =	$ 24,354
(*5*) 66.67% of this paragraph (g)(4), *Example 2* (iii)(A)(*4*) less $8,117 (amount due with first installment) =	$ 8,120

(B) Because the total amount of estimated tax available to apply towards the amount due for the second installment ($11,883 ($10,000 paid on the second installment date plus $1,883 overpayment of the first installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on June 15, 2009.

(iv)(A) Pursuant to paragraph (c) and (d) of this section, the final required installment is due by September 15, 2009, and the applicable percentage due for the final required installment is 100%. To determine whether the installment payments made on or before September 15, 2009, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 7-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 7 month period =	$240,000
(2) Tax on this paragraph (g)(4), *Example 2* (iv)(A)(*1*) =	$ 76,850
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iv)(A)(2) divided by 12 multiplied by 7 (the number of months in the short taxable year) =	$ 44,829
(*4*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*3*) =	$ 44,829
(*5*) 100% of this paragraph (g)(4), *Example 2* (iv)(A)(*4*) less $16,237 (amount due with first and second installment) =	$ 28,592

(B) Because the total amount of estimated tax available to apply towards the amount due for the final installment ($23,763 ($20,000 that is timely paid on the third installment date plus $3,763 overpayment of the second installment)) does not exceed the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) does not apply and an addition to tax will be imposed for the final installment due on September 15, 2009, unless another exception (for example, see section 6655(e)(3)) applies with respect to these installments.

(h) *Effective/applicability date.* This section applies to taxable years beginning after September 6, 2007.

§1.6655–6 Methods of accounting.

(a) *In general.* In computing any required installment, a corporation must use the methods of accounting used in computing taxable income for the taxable year for which estimated tax is being determined (the current taxable year).

(b) *Accounting method changes.* A taxpayer that changes its method of accounting with the consent of the Commissioner for the current taxable year must use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for annualization periods ending on or after the date the related section 481(a) adjustment is treated as arising. See §1.6655–2(f)(3)(ii)(C) for the date a section 481(a) adjustment is treated as arising. If the change in method of accounting does not result in a section 481(a) adjustment, the taxpayer may choose to use the new method of accounting (as of the beginning of the taxable year) in the determination of taxable income for all annualization periods during the year of change or only those annualization periods ending on or after the date the Form 3115 *"Application for Change in Accounting Method"* was filed with the national office of the Internal Revenue Service. This paragraph (b) only applies to the extent a taxpayer changes a method of accounting for the taxable year with the consent of the Commissioner. Therefore, a taxpayer may be subject to a section 6655 addition to tax for an underpayment of estimated tax if an underpayment results from a change in a method of accounting the taxpayer anticipates making for the taxable year but for

which the consent of the Commissioner is not subsequently received.

(c) *Examples*. The following examples illustrate the rules of this section:

Example 1. Accounting method used in computing taxable income for the taxable year. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. ABC receives advance payments each taxable year with respect to agreements for the sale of goods properly includible in ABC's inventory. The advance payments received by ABC qualify for deferral under §1.451–5(c). Although ABC is eligible to defer the advance payments in accordance with §1.451–5(c), ABC's method of accounting with respect to the advance payments is to include the advance payments in income when received and ABC does not change its accounting method for advance payments for the 2008 taxable year. ABC must use its current method of recognizing advance payments as income in the year received for purposes of computing its 2008 required installments.

Example 2. Change of accounting method. Corporation ABC, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate all of its 2008 required installments. On June 15, 2008, ABC files a Form 3115 requesting permission to change its method of accounting for future litigation reserves for the tax year ending December 31, 2008. On February 15, 2009, ABC receives consent from the Commissioner to make the change for the tax year ending December 31, 2008. The change results in a positive section 481(a) adjustment of $100,000. Under the provisions of §1.6655–2(f)(3)(ii), ABC chooses to treat the section 481(a) adjustment as arising on the date the Form 3115 is filed with the national office of the Internal Revenue Service. Therefore, ABC is required to use the new method of accounting (as of the beginning of the year) in the determination of taxable income for annualization periods ending on or after June 15, 2008.

(d) *Effective/applicability date*. This section applies to taxable years beginning after September 6, 2007.

Par. 13. Newly-designated §1.6655–7 is revised to read as follows:

§1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

(a) Section 6655(h) imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any excessive amount (as defined in paragraph (c) of this section) of an adjustment under section 6425 that is made before the 15th day of the third month following the close of a taxable year beginning after December 31, 1967. This addition to tax is imposed whether or not there was reasonable cause for an excessive adjustment.

(b) If the amount of an adjustment under section 6425 is excessive, there shall be added to the tax under chapter 1 of the Internal Revenue Code for the taxable year an amount determined at the annual rate referred to in the regulations under section 6621 upon the excessive amount from the date on which the credit is allowed or refund paid to the 15th day of the third month following the close of the taxable year. A refund is paid on the date it is allowed under section 6407.

(c) The excessive amount is equal to the lesser of the amount of the adjustment or the amount by which—

(1) The income tax liability (as defined in section 6425(c)) for the taxable year, as shown on the return for the taxable year; exceeds

(2) The estimated income tax paid during the taxable year, reduced by the amount of the adjustment.

(d) The computation of the addition to the tax imposed by section 6425 is made independent of, and does not affect the computation of, any addition to the tax that a corporation may otherwise owe for an underpayment of an installment of estimated tax.

(e) The following example illustrates the rules of this section:

Example. (i) Corporation X, a calendar year taxpayer, had an underpayment as defined in section 6655(b), for its fourth installment of estimated tax that was due on December 15, 2009, in the amount of $10,000. On January 4, 2010, X filed an application for adjustment of overpayment of estimated income tax for 2009 in the amount of $20,000.

(ii) On February 16, 2010, the Internal Revenue Service, in response to the application, refunded $20,000 to X. On March 15, 2010, X filed its 2009 tax return and made a payment in settlement of its total tax liability. Assuming that the addition to tax is computed under section 6621(a)(2) at a rate of 8% *per annum* for the applicable periods of underpayment, under section 6655(a), X is subject to an addition to tax in the amount of $197 (90/365 X $10,000 X 8%) on account of X's December 15, 2009, underpayment. Under section 6655(h), X is subject to an addition to tax in the amount of $118 (27/365 X $20,000 X 8%) on account of X's excessive adjustment under section 6425. In determining the amount of the addition to tax under section 6655(a) for failure to pay estimated income tax, the excessive adjustment under section 6425 is not taken into account.

(f) An adjustment is generally to be treated as a reduction of estimated income tax paid as of the date of the adjustment. However, for purposes of §§1.6655–1 through 1.6655–6, the adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed.

(g) *Effective/applicability date*: This section applies to taxable years beginning after September 6, 2007.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 14. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§301.6154–1 [Removed]

Par. 15. Section 301.6154–1 is removed.

Par. 16. Section 301.6655–1 is revised to read as follows:

§301.6655–1 Failure by corporation to pay estimated income tax.

(a) For regulations under section 6655, see §§1.6655–1 through 1.6655–7 of this chapter.

(b) *Effective/applicability date*: This section applies to taxable years beginning after September 6, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 17. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 18. Section 602.101, paragraph (b) is amended by removing the entries for §§1.6154–2, 1.6154–3, 1.6154–5, 1.6655–1, 1.6655–2, 1.6655–3 and 1.6655–7.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 17, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 7, 2007, 72 F.R. 44337)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Public Inspection of Material Relating to Tax-Exempt Organizations

REG–116215–07

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that amend existing regulations issued under sections 6104 and 6110 of the Internal Revenue Code. The purpose of the proposed regulations is to clarify rules relating to information that is made available by the IRS for public inspection under section 6104(a) and materials that are made publicly available under section 6110. The changes reflect IRS practice as well as the United States Court of Appeals for the District of Columbia Circuit's decision in *Tax Analysts v. IRS*, 350 F.3d 100 (D.C. Cir. 2003). The *Tax Analysts* decision invalidated the portions of §§301.6104(a)–1(i) and 301.6110–1(a) that excepted rulings that denied or revoked an organization's tax exempt status from the public disclosure provisions of both sections 6104 and 6110. The proposed regulations will affect organizations exempt from Federal income tax under section 501(a) or 527, organizations that were exempt but are no longer exempt from Federal income tax, and organizations that were denied tax-exempt status.

DATES: Written or electronic comments and requests for a public hearing must be received by November 13, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–116215–07), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–116215–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–116215–07).

FOR FURTHER INFORMATION CONTACT: Concerning submission of comments, Kelly Banks, (202) 622–7180 (not a toll-free number); concerning the proposed regulations, Mary Ellen Keys, (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Since 1950, the Internal Revenue Code has provided for the public inspection of information that is submitted to the IRS by certain exempt organizations and certain trusts. Under section 6104(a), the IRS makes available for public inspection approved applications for exemption from Federal income tax for organizations described in section 501(c) or (d) and exempt under section 501(a), notices of status filed under section 527(i) by political organizations exempt from taxation under section 527, and certain related documents. Section 6104(a) also permits the IRS to disclose whether an organization is currently recognized as exempt and the subsection and paragraph number of section 501 under which it is recognized. Section 6104(b) imposes an additional obligation on the IRS to make available for public inspection annual information returns filed by organizations exempt from Federal income tax. Section 6104(c) governs when the IRS may disclose certain information about charitable and certain other exempt organizations to state officials. Section 6104(d) imposes a parallel obligation on organizations and trusts to make available for public inspection annual returns, applications for exemption and notices of status. The proposed regulations do not address the obligations imposed by subsections (b), (c) and (d).

The decision in *Tax Analysts v. IRS*, 350 F.3d 100 (D.C. Cir. 2003), invalidated the portions of existing §301.6104(a)–1(i)(1), (2), and (3) and §301.6110–1(a) that excluded rulings that denied or revoked an organization's tax exempt status from the public disclosure provisions of both sections 6104 and 6110. Sections 301.6104(a)–1(i)(1), (2) and (3) excluded from disclosure by the IRS unfavorable rulings or determination letters in response to exemption applications, rulings or determination letters that make or modify a favorable determination letter, and technical advice memoranda that relate to a disapproved exemption application or the revocation or modification of a favorable determination letter. Thus, because §301.6110–1(a) provided that the disclosure of such rulings, determination letters and technical advice memoranda is to be determined under section 6104, they also were not available under section 6110. The IRS has already modified its administrative practice to follow the court's holding by making these documents available to the public. See AOD 2004–2, 2004–29 I.R.B., §601.601(d)(2)(ii)(a). The Treasury Department and IRS now propose to revise the existing regulations at §301.6104(a)–1 and §301.6110–1(a) to conform to the court's holding in *Tax Analysts*.

Explanation of Provisions

The proposed regulations remove existing §301.6104(a)–1(i) and portions of §301.6110–1(a), in light of the holding in *Tax Analysts*. The proposed regulations clarify that the term "application" includes information submitted to the IRS relating to group exemption applications. The proposed regulations provide that notices of status filed under section 527(i) and the documents comprising the notices are available for public inspection under section 6104(a). The proposed regulations also add to the material that is available for public inspection the letters or documents filed with or issued by the IRS relating to an organization's status as an organization described in sections 509(a), 4942(j)(3), or 4943(f), including a final determination letter that the organization is or is not a private foundation.

The proposed regulations clarify that the IRS may disclose, in response to or in anticipation of a request, the subsection and paragraph number of section 501 under which an organization or group has been determined, on the basis of its application, to qualify for exemption from Federal income tax, and whether an organiza-

tion or group is currently recognized as exempt.

Section 6104(a) applies to the publication of certain information related to organizations that are exempt from Federal income taxation under section 501(a). The information covered by section 6104(a) includes material for any taxable year during which the organization was exempt. Under the proposed regulations, written determinations issued by the IRS, including, for example, unfavorable rulings or determination letters issued in response to applications for tax exemption and rulings or determination letters revoking or modifying a favorable determination letter, are made available for public inspection under section 6110.

Other changes to the existing regulations

The proposed regulations reorganize or revise certain provisions of the existing regulations to eliminate redundancy and/or to provide greater clarity. First, §301.6104(a)–1(a) is revised to clarify that applications for exemption from Federal income tax and supporting documents shall be open for public inspection, even if the IRS subsequently revokes the organization's exempt status.

Second, new §301.6104(a)–1(b) is added to clarify that notices of status filed by political organizations described in section 527 are open for public inspection.

Third, §301.6104(a)–1(c) (formerly §301.6104(a)–1(b)) is revised to clarify that group exemption letters are included among the information that is available for public inspection under section 6104(a).

Fourth, §301.6104(a)–1(d) (formerly §301.6104(a)–1(c)) is revised to clarify that, where an organization is determined to be exempt for any taxable year, material shall not be withheld on the basis that the organization is determined not to be exempt for any other taxable year.

Fifth, §301.6104(a)–1(g) (formerly §301.6104(a)–1(e)), which defines the term "supporting document" with respect to an application for exemption from Federal income tax, is revised to clarify that there are no supporting documents with respect to notices of status filed by political organizations.

Sixth, new §301.6104(a)–1(h) is added to clarify that the IRS may disclose, in response to or in anticipation of a request, the subsection and paragraph number of section 501 under which an organization or group has been determined to be exempt from Federal income taxation, whether an organization or group is exempt, or whether the IRS has revoked an organization's or group's exemption under section 501(c)(3).

Finally, new §301.6104(a)–1(i) is added to refer the reader to section 6033(j), added to the Code by the Pension Protection Act of 2006, Pub. L. 109–280, 120 Stat. 780, which is an additional statutory provision that requires disclosure of information by the IRS regarding organizations formerly exempt from Federal income tax. Section 6033(j) governs the publication and maintenance of a list of organizations whose tax exempt status was revoked for failure to file required returns or notices for three consecutive years. Likewise, this paragraph cross-references section 7428(c), which relates to the revocation of a determination of exempt status, and section 501(p), added to the Code by the Military Family Tax Relief Act of 2003, Pub. L. 108–121, 117 Stat. 1335, which relates to suspension of the tax-exempt status of terrorist organizations, including public notice of suspensions.

Special Analyses

It has been determined that the proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to the regulations, and, therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of the regulations is Mary Ellen Keys, Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805 ***

Par. 2. §301.6104(a)–1 is revised to read as follows:

§301.6104(a)–1 Public inspection of material relating to tax-exempt organizations.

(a) *Applications for exemption from Federal income tax, applications for a group exemption letter and supporting documents.* If the Internal Revenue Service determines that an organization described in section 501(c) or (d) is exempt from Federal income tax for any taxable year, the application upon which the determination is based, together with any supporting documents, shall be open to public inspection. Such applications and supporting documents shall be open for public inspection even after any revocation of the Internal Revenue Service's determination that the organization is exempt from Federal income tax. Some applications have been destroyed and therefore are not available for inspection. For purposes of determining the availability for public inspection, a claim for exemption

from Federal income tax filed to reestablish exempt status after denial thereof under the provisions of section 503 or 504 (as in effect on December 31, 1969), or under the corresponding provisions of any prior revenue law, is considered an application for exemption from Federal income tax.

(b) *Notices of status filed by political organizations.* If, in accordance with section 527(i), an organization notifies the Internal Revenue Service that it is a political organization as described in section 527, exempt from Federal income tax for any taxable year, the notice of status filed by the political organization shall be open to public inspection.

(c) *Letters or documents issued by the Internal Revenue Service with respect to an application for exemption from Federal income tax.* If an application for exemption from Federal income tax is filed with the Internal Revenue Service after October 31, 1976, and is open to public inspection under paragraph (a) of this section, then any letter or document issued to the applicant by the Internal Revenue Service that relates to the application is also open to public inspection. For rules relating to when a letter or document is issued, see §301.6110–2(h). Letters or documents to which this paragraph applies include, but are not limited to—

(1) Favorable rulings and determination letters, including group exemption letters, issued in response to applications for exemption from Federal income tax;

(2) Technical advice memoranda issued with respect to the approval, or subsequent approval, of an application for exemption from Federal income tax;

(3) Letters issued in response to an application for exemption from Federal income tax (including applications for a group exemption letter) that propose a finding that the applicant is not entitled to be exempt from Federal income tax, if the applicant is subsequently determined, on the basis of that application, to be exempt from Federal income tax; and

(4) Any letter or document issued by the Internal Revenue Service relating to an organization's status as an organization described in sections 509(a), 4942(j)(3), or 4943(f), including a final determination letter that the organization is or is not a private foundation.

(d) *Requirement of exempt status.* An application for exemption from Federal income tax (including applications for a group exemption letter), supporting documents, and letters or documents issued by the Internal Revenue Service that relate to the application shall not be open to public inspection before the organization is determined, on the basis of that application, to be exempt from Federal income tax for any taxable year. If an organization is determined to be exempt from Federal income tax for any taxable year, these materials shall not be withheld from public inspection on the basis that the organization is subsequently determined not to be exempt for any other taxable year.

(e) *Documents included in the term "application for exemption from Federal income tax."* For purposes of this section—

(1) *Prescribed application form.* If a form is prescribed for an organization's application for exemption from Federal income tax, the application includes the form and all documents and statements that the Internal Revenue Service requires to be filed with the form, any amendments or revisions to the original application, or any resubmitted applications where the original application was submitted in draft form or was withdrawn. An application submitted in draft form or an application submitted and later withdrawn is not considered an application.

(2) *No prescribed application form.* If no form is prescribed for an organization's application for exemption from Federal income tax, the application includes the submission by letter requesting recognition of tax exemption and any statements or documents as prescribed by Revenue Procedure 2007–52, 2007–30 I.R.B. 222, and any successor guidance. (See §601.201(n)(7)(i) of the Statement of Procedural Rules, 26 CFR part 601.)

(3) *Application for a Group Exemption Letter.* The application for a group exemption letter includes the letter submitted by or on behalf of subordinate organizations that seek exempt status pursuant to a group exemption letter and any statements or documents as prescribed by Revenue Procedure 80–27, 1980–1 C.B. 677, and any successor guidance. (See §601.201(n)(8)(i) of the Statement of Procedural Rules, 26 CFR part 601.)

(4) *Notice of status filed under section 527(i).* For purposes of this section, documents included in the term "notice of status filed under section 527(i)" include—

(i) Form 8871, *Political Organization Notice of Section 527 Status*;

(ii) Form 8453–X, *Political Organization Declaration for Electronic Filing of Notice of Section 527 Status*; and

(iii) Any other additional forms or documents that the Internal Revenue Service may prescribe.

(f) *Material open to public inspection under section 6110.* Under section 6110, certain written determinations issued by the Internal Revenue Service are made available for public inspection. Section 6110 does not apply, however, to material that is open to public inspection under section 6104. See section 6110(l)(1).

(g) *Supporting documents defined.* For purposes of this section, "supporting documents," with respect to an application for exemption from Federal income tax, means any statement or document not described in paragraph (e) of this section that is submitted by the organization or group in support of its application prior to a determination described in paragraph (c) of this section. Items submitted in connection with an application in draft form, or with an application submitted and later withdrawn, are not supporting documents. There are no supporting documents with respect to Notices of Status filed by political organizations.

(h) *Statement of exempt status.* For efficient tax administration, the Internal Revenue Service may publish, in paper or electronic format, the names of organizations currently recognized as exempt from Federal income tax, including organizations recognized as exempt from Federal income tax under particular paragraphs of section 501(c) or section 501(d). In addition to having the opportunity to inspect material relating to an organization exempt from Federal income tax, a person may request a statement, or the Internal Revenue Service may disclose, in response to or in anticipation of a request, the following information—

(1) The subsection and paragraph of section 501 (or the corresponding provision of any prior revenue law) under which the organization or group has been determined, on the basis of an application open

to public inspection, to qualify for exemption from Federal income tax; and

(2) Whether an organization or group is currently recognized as exempt from Federal income tax.

(i) *Publication of non-exempt status*—(1) For publication of the notice of the revocation of a determination that an organization is described in section 501(c)(3), see section 7428(c).

(2) For publication of a list including any organization the tax exemption of which is revoked for failure to file required returns or notices for three consecutive years, see section 6033(j).

(3) For publication of notice of suspension of tax exemption of terrorist organizations, see section 501(p).

(j) *Withholding of certain information from public inspection.* For rules relating to certain information contained in an application for exemption from Federal income tax and supporting documents that will be withheld from public inspection, see §301.6104(a)–5(a).

(k) *Procedures for inspection.* For rules relating to procedures for public inspection of applications for exemption from Federal income tax and supporting documents, see §301.6104(a)–6.

(l) *Effective/applicability date.* The rules of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register.**

Par. 3. §301.6110–1 is amended by:

1. Revising paragraph (a).

2. Adding paragraph (d).

The addition and revision read as follows:

§301.6110–1 Public inspection of written determinations and background file documents.

(a) *General rule.* Except as provided in §301.6110–3, relating to deletion of certain information, §301.6110–5(b), relating to actions to restrain disclosure, paragraph (b)(2) of this section, relating to technical advice memoranda involving civil fraud and criminal investigations, and jeopardy and termination assessments, and paragraph (b)(3) of this section, relating to general written determinations relating to accounting or funding periods and methods, the text of any written determination (as defined in §301.6110–2(a)) issued pursuant to a request postmarked or hand delivered after October 31, 1976, shall be open to public inspection in the places provided in paragraph (c)(1) of this section. The text of any written determination issued pursuant to a request postmarked or hand delivered before November 1, 1976, shall be open to public inspection pursuant to section 6110(h) and §301.6110–6, when funds are appropriated by Congress for such purpose. The procedures and rules set forth in §§301.6110–1 through 301.6110–5 and §301.6110–7 do not apply to written determinations issued pursuant to requests postmarked or hand delivered before November 1, 1976, unless §301.6110–6 states otherwise. There shall also be open to public inspection in each place of public inspection an index to the written determinations subject to inspection at such place. Each such index shall be arranged by section of the Internal Revenue Code, related statute or tax treaty and by subject matter description within such section in such manner as the Commissioner may from time to time provide. The Commissioner shall not be required to make any written determination or background file document open to public inspection pursuant to section 6110 or refrain from disclosure of any such documents or any information therein, except as provided by section 6110 or with respect to a discovery order made in connection with a judicial proceeding. The provisions of section 6110 shall not apply to material that is open to public inspection under section 6104. See section 6110(l)(1).

* * * * *

(d) *Effective/applicability date.* The rules of paragraph (a) of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2007, 72 F.R. 45394)

Qualified Films Under Section 199; Correction

Announcement 2007–77

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG–103842–07, 2007–28 I.R.B. 79) that was published in the **Federal Register** on Thursday, June 7, 2007 (72 FR 31478). These regulations involve the deduction for income attributable to domestic production activities under section 199 and affect taxpayers who produce qualified films under section 199(c)(4)(A)(i)(II) and (c)(6) and taxpayers who are members of an expanded affiliated group under section 199(d)(4).

FOR FURTHER INFORMATION CONTACT: Concerning §1.199–3(k) of the proposed regulations, David McDonnell at (202) 622–3040; concerning §1.199–7 of the proposed regulations, Ken Cohen (202) 622–7790 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–103842–07) that is the subject of the correction is under section 199 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–103842–07) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–103842–07), that is the subject of FR Doc. E7–10821, is corrected as follows:

1. On page 31480, column 2, in the preamble, under the paragraph heading "*Expanded Affiliated Groups*", second paragraph of the column, lines 25 through 28,

the language "assume that X and Y each have $60 of taxable income and QPAI in 2007, Z has $170 of taxable income and QPAI in 2008, and that X, Y, and Z each have" is corrected to read "assume that X and Y each has $60 of taxable income and QPAI in 2007, Z has $170 of taxable income and QPAI in 2008, and that X, Y, and Z each has".

§1.199–3 [Corrected]

2. On page 31482, column 1, §1.199–3(k)(7)(i), line 2 from the bottom of the paragraph, the language "Paragraph (g)(4)(ii)(A) of this section" is corrected to read "Paragraph (g)(3)(ii)(A) of this section".

§1.199–7 [Corrected]

3. On page 31482, column 3, §1.199–7(e) *Example 10.* paragraph (i), line 5 of the paragraph, the language "B each use the section 861 method for" is corrected to read "B each uses the section 861 method for".

4. On page 31482, column 3, §1.199–7(e) *Example 10.* paragraph (iii), line 8 of the paragraph, the language "B becomes a non-member of the consolidated" is corrected to read "B becomes a nonmember of the consolidated".

5. On page 31483, column 1, §1.199–7(g)(3) *Example.* paragraph (i), lines 9 through 11 of the paragraph, the language "year, neither X, Y, nor Z join in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each have W–2" is corrected to read "year, neither X, Y, nor Z joins in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each has W–2".

6. On page 31483, column 1, §1.199–7(g)(3) *Example.* paragraph (ii), line 5 from the bottom of the column, the language "allocated $96 of the deduction. For the" is corrected to read "allocated $96 of the EAG's section 199 deduction. For the".

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on July 19, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2007, 72 F.R. 39770)

Application of Section 409A to Nonqualified Deferred Compensation Plans; Correction

Announcement 2007–78

ACTION: Correcting amendments.

AGENCY: Internal Revenue Service (IRS), Treasury.

SUMMARY: This document contains corrections to final regulations (T.D. 9321, 2007–19 I.R.B. 1123) that were published in the **Federal Register** on Tuesday, April 17, 2007 (73 FR 19234), relating to section 409A.

DATES: This correction is effective April 17, 2007.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney, (202) 622–9639 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under section 409A of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9321) contain errors that may prove misleading and are in need of clarification.

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

* * * * *

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

§1.409A–1 [Corrected]

Par. 2. Section 1.409A–1 is amended as follows:

1. Paragraph (a)(3)(i) is revised.

2. The first and second sentences of paragraph (a)(5) are revised.

3. The first sentences of paragraphs (b)(4)(i) and (b)(4)(i)(D) are revised.

4. *Examples 3* and *5* in paragraph (b)(4)(iii) are amended by revising the last sentences of the paragraphs.

5. Paragraph (b)(5)(iv)(B)(*2*)(*ii*) is revised.

6. In paragraph (b)(8)(iii) the first sentence is revised.

7. The first sentence of paragraph (b)(9)(v)(A) is revised.

8. Paragraph (c)(2)(i)(H) is revised.

9. Paragraph (c)(3)(viii) is revised.

10. The last sentence of paragraph (f)(1) is revised.

11. The ninth sentence of paragraph (h)(1)(ii) is revised.

12. The first sentence of paragraph (i)(2) is revised.

§1.409A–1 Definitions and covered plans.

(a) * * *

(3) * * *

(i) * * * With respect to an individual for a taxable year, the term *nonqualified deferred compensation plan* does not include any scheme, trust, arrangement, or plan maintained with respect to such individual, to the extent contributions made by or on behalf of such individual to such scheme, trust, arrangement, or plan, or credited allocations, accrued benefits, earnings, or other amounts constituting income, of such individual under such scheme, trust, arrangement, or plan, are excludable by such individual for Federal income tax purposes pursuant to any bilateral income tax convention, or other bilateral or multilateral agreement, to which the United States is a party.

* * * * *

(5) * * * The term *nonqualified deferred compensation plan* does not include a plan, or a portion of a plan, to the extent that the plan provides *bona fide* vacation leave, sick leave, compensatory time, disability pay, or death benefits. For these purposes, the terms "disability pay" and "death benefits" have the same meanings as provided in §31.3121(v)(2)–1(b)(4)(iv)(C) of this chapter, provided that for purposes of this paragraph, such disability pay and death benefits may be provided through insurance and the lifetime benefits payable

under the plan are not treated as including the value of any taxable term life insurance coverage or taxable disability insurance coverage provided under the plan. * * *

(b) * * *

(4) * * * (i) *In general.* A deferral of compensation does not occur under a plan with respect to any payment (as defined in §1.409A–2(b)(2)) that is not a deferred payment, provided that the service provider actually or constructively receives such payment on or before the last day of the applicable 2½ month period. * * *

* * * * *

(D) A payment is a deferred payment if it is made pursuant to a provision of a plan that provides for the payment to be made or completed on or after any date, or upon or after the occurrence of any event, that will or may occur later than the end of the applicable 2½ month period, such as a separation from service, death, disability, change in control event, specified time or schedule of payment, or unforeseeable emergency, regardless of whether an amount is actually paid as a result of the occurrence of such a payment date or event during the applicable 2½ month period. * * *

* * * * *

(iii) * * *

Example 3. * * * The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee C on or before March 15, 2011.

* * * * *

Example 5. * * * The bonus plan provides for a deferral of compensation, and will not qualify as a short-term deferral regardless of whether the bonus is paid or made available on or before March 15, 2011 (and generally any payment before June 1, 2011 would constitute an impermissible acceleration of a payment).

* * * * *

(5) * * *

(iv) * * *

(B) * * *

(*2*) * * *

(*ii*) A valuation based upon a formula that, if used as part of a nonlapse restriction (as defined in §1.83–3(h)) with respect to the stock, would be considered to be the fair market value of the stock pursuant to §1.83–5, provided that such stock is valued in the same manner for purposes of any transfer of any shares of such class of stock (or any substantially similar class of stock) to the issuer or any person that owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the issuer (applying the stock attribution rules of §1.424–1(d)), other than an arm's length transaction involving the sale of all or substantially all of the outstanding stock of the issuer, and such valuation method is used consistently for all such purposes, and provided further that this paragraph (b)(5)(iv)(B)(*2*)(*ii*) does not apply with respect to stock subject to a stock right payable in stock, where the stock acquired pursuant to the exercise of the stock right is transferable other than through the operation of a nonlapse restriction.

* * * * *

(8) * * *

(iii) * * * A tax equalization agreement does not provide for a deferral of compensation if payments made under such tax equalization agreement are made no later than the end of the second taxable year of the service provider beginning after the taxable year of the service provider in which the service provider's U.S. Federal income tax return is required to be filed (including any extensions) for the year to which the compensation subject to the tax equalization payment relates, or, if later, the second taxable year of the service provider beginning after the latest such taxable year in which the service provider's foreign tax return or payment is required to be filed or made for the year to which the compensation subject to the tax equalization payment relates. * * *

* * * * *

(9) * * *

(v) * * *

(A) * * * To the extent a separation pay plan (including a plan providing payments upon a voluntary separation from service) entitles a service provider to payment by the service recipient of reimbursements that are not otherwise excludible from gross income for expenses that the service provider could otherwise deduct under section 162 or section 167 as business expenses incurred in connection with the performance of services (ignoring any applicable limitation based on adjusted gross income), or of reasonable outplacement expenses and reasonable moving expenses actually incurred by the service provider and directly related to the termination of services for the service recipient, such plan does not provide for a deferral of compensation to the extent such rights apply during a limited period of time (regardless of whether such rights extend beyond the limited period of time). * * *

* * * * *

(c) * * *

(2) * * *

(i) * * *

(H) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent such plans are stock rights (as defined in paragraph (l) of this section) subject to section 409A, are treated as deferred under a single plan.

* * * * *

(3) * * *

(viii) * * * The plan aggregation rules of paragraph (c)(2)(i) of this section do not apply to the written plan requirements of this paragraph (c)(3). Accordingly, deferrals of compensation under an agreement, method, program, or other arrangement that fails to meet the requirements of section 409A solely due to a failure to meet the written plan requirements of this paragraph (c)(3) are not aggregated with deferrals of compensation under other agreements, methods, programs, or other arrangements that meet such requirements.

* * * * *

(f) * * *

(1) *In general.* * * * The term *service provider* generally includes a person who has separated from service (a former service provider).

* * * * *

(h) * * *

(1) * * *

(ii) *Termination of employment.* * * * Notwithstanding the foregoing provisions of this paragraph (h)(1)(ii), a plan may treat another level of reasonably anticipated permanent reduction in the level of *bona fide* services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of *bona fide* services must be greater than 20 percent but less that 50 percent of the average level of *bona fide* services provided in the immediately preceding 36 months. * * *

* * * * *

(i) * * *

(2) * * * For purposes of identifying a specified employee by applying the requirements of section 416(i)(1)(A)(i), (ii), and (iii), the definition of compensation under §1.415(c)–2(a) is used, applied as if the service recipient were not using any safe harbor provided in §1.415(c)–2(d), were not using any of the elective special timing rules provided in §1.415(c)–2(e), and were not using any of the elective special rules provided in §1.415(c)–2(g). * * *

* * * * *

§1.409A–2 [Corrected]

Par. 3. Section 1.409A–2 is amended as follows:

1. The first sentences of paragraphs (a)(6) and (a)(9) are revised.

2. The third sentence of paragraph (b)(2)(ii)(A) is revised.

3. A new sentence is added after the third sentence of paragraph (b)(2)(ii)(A).

§1.409A–2 Deferral elections.

(a) * * *

(6) * * * In the case of a service recipient with a taxable year that is not the same as the taxable year of the service provider, a plan may provide that fiscal year compensation may be deferred at the service provider's election if the election to defer such compensation is made not later than the close of the service recipient's taxable year immediately preceding the first taxable year of the service recipient in which any services are performed for which such compensation is payable. * * *

* * * * *

(9) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is determined under the formula for determining benefits under a qualified employer plan (as defined in §1.409A–1(a)(2)) or a broad-based foreign retirement plan (as defined in §1.409A–1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or the broad-based foreign retirement plan, an increase in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (a)(9)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute a deferral election under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that such change in the amounts deferred under the nonqualified deferred compensation plan does not exceed that change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) * * * For purposes of §1.409A–1, this section, and §§1.409A–3 through 1.409A–6, the term *life annuity* means a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, or a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, followed upon the death or end of the life expectancy of the service provider by a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider's designated beneficiary (if any). Notwithstanding the foregoing, a schedule of payments does not fail to be an annuity solely because such plan provides for an immediate payment of the actuarial present value of all remaining annuity payments if the actuarial present value of the remaining annuity payments falls below a predetermined amount, and the immediate payment of such amount does not constitute an accelerated payment for purposes of §1.409A–3(j), provided that such feature, including the predetermined amount, is established by no later than the time and form of payment is otherwise required to be established, and provided further that any change in such feature, including the predetermined amount, is a change in the time and form of payment. * * *

* * * * *

§1.409A–3 [Corrected]

Par. 4. Section 1.409A–3 is amended as follows:

1. The first sentence of paragraph (c) is revised.

2. The last sentence of paragraph (i)(1)(ii)(B) is revised.

3. The fourth sentence of paragraph (i)(3)(ii) is revised.

4. The last sentence of paragraph (j)(4)(vi) is revised.

5. The last sentence of paragraph (j)(4)(ix)(B) is revised.

6. The first sentence of paragraph (j)(5) is revised.

7. Paragraph (j)(5)(iv) is revised.

§1.409A–3 Permissible payments.

* * * * *

(c) * * * Except as otherwise provided in this paragraph (c), for an amount of deferred compensation under a plan, the plan may designate only one time and form of payment upon the occurrence of each event described in paragraph (a)(1), (2), (3), (5), or (6) of this section. * * *

* * * * *

(i) * * *

(1) * * *

(ii) * * *

(B) * * * A change in the limitation or a change in the time and form of payment of any payment that is not otherwise made at the scheduled payment date due to application of the formula limitation is subject to the requirements of §1.409A–2(b) (subsequent deferral elections) and paragraph (j) of this section (accelerated payments).

* * * * *

(3) * * *

(ii) * * * However, the determination of amounts reasonably necessary to satisfy the emergency need is not required to

take into account any additional compensation that is available from a qualified employer plan as defined in §1.409A–1(a)(2) (including any amount available by obtaining a loan under the plan), or that due to the unforeseeable emergency is available under another nonqualified deferred compensation plan (including a plan that would provide for deferred compensation except due to the application of the effective date provisions under §1.409A–6). * * *

* * * * *

(j) * * *

(4) * * *

(vi) * * * However, the total payment under this acceleration provision must not exceed the aggregate of the FICA or RRTA amount, and the income tax withholding related to such FICA or RRTA amount.

* * * * *

(ix) * * *

(B) * * * Solely for purposes of this paragraph (j)(4)(ix)(B), the applicable service recipient with the discretion to liquidate and terminate the agreements, methods, programs, and other arrangements is the service recipient that is primarily liable immediately after the transaction for the payment of the deferred compensation.

* * * * *

(5) * * * If a nonqualified deferred compensation plan provides that the amount deferred under the plan is the amount determined under the formula determining benefits under a qualified employer plan (as defined in §1.409A–1(a)(2)), or a broad-based foreign retirement plan (as defined in §1.409A–1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan or broad-based foreign retirement plan, a decrease in amounts deferred under the nonqualified deferred compensation plan that results directly from the operation of the qualified employer plan or broad-based foreign retirement plan (other than service provider actions described in paragraphs (j)(5)(iii) and (iv) of this section) including changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute an acceleration of a payment under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that the change in the amounts deferred under the nonqualified deferred compensation plan does not exceed such change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. * * *

* * * * *

(iv) A service provider's action or inaction under a qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contributions restrictions under section 401(a)(30) or section 402(g), and after-tax contributions by the service provider to a qualified employer plan that provides for such contributions, that affects the amounts that are credited under one or more nonqualified deferred compensation plans as matching amounts or other similar amounts contingent on such elective deferrals, pre-tax contributions, or after-tax contributions, provided that the total of such matching or contingent amounts, as applicable, never exceeds 100 percent of the matching or contingent amounts that would be provided under the qualified employer plan absent any plan-based restrictions that reflect limits on qualified plan contributions under the Internal Revenue Code.

* * * * *

§1.409A–6 [Corrected]

Par. 5. Section 1.409A–6 is amended by revising paragraphs (a)(3)(i) and (ii) and (a)(4)(iv) to read as follows:

§1.409A–6 Application of section 409A and effective dates.

* * * * *

(a) * * *

(3) * * *

(i) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in §1.409A–1(c)(2)(i)(C)), equals the present value of the amount to which the service provider would have been entitled under the plan if the service provider voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of services, and received the benefits in the form with the maximum value. * * *

(ii) * * * The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is an account balance plan (as defined in §1.409A–1(c)(2)(i)(A)), equals the portion of the service provider's account balance as of December 31, 2004, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, plus any future contributions to the account, the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, to the extent such contributions are actually made.

* * * * *

(4) * * *

(iv) * * * With respect to an account balance plan (as defined in §1.409A–1(c)(2)(i)(A)), it is not a material modification to change a notional investment measure to, or to add to an existing investment measure, an investment measure that qualifies as a predetermined actual investment within the meaning of §31.3121(v)(2)–1(d)(2) of this chapter or, for any given taxable year, reflects a reasonable rate of interest (determined in accordance with §31.3121(v)(2)–1(d)(2)(i)(C) of this chapter). * * *

* * * * *

Guy R. Traynor,
Federal Register Liaison,
Legal Processing Division,
Publication & Regulations Branch,
Associate Chief Counsel
(Procedure & Administration).

(Filed by the Office of the Federal Register on July 30, 2007, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2007, 72 F.R. 41620)

Built-in Gains and Losses Under Section 382(h); Correction

Announcement 2007-80

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains corrections to temporary regulations (T.D. 9330, 2007-31 I.R.B. 239) that were published in the **Federal Register** on Thursday, June 14, 2007 (72 FR 32792) applying to corporations that have undergone ownership changes within the meaning of section 382. These regulations provide guidance regarding the treatment of prepaid income under the built-in gain provisions of section 382(h).

DATES: These corrections are effective August 1, 2007.

FOR FURTHER INFORMATION CONTACT: Keith Stanley at (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subject of this document are under section 382 of the Internal Revenue Code.

Need for Correction

As published, temporary regulations (T.D. 9330) contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.382-7T is amended by revising paragraph (b)(2) to read as follows:

§1.382-7T Built-in gains and losses (temporary).

* * * * *

(b) * * *

(2) The applicability of this section expires on June 14, 2010.

Par. 3. The signature block is revised by adding the language "Approved: June 4, 2007."

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on July 31, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2007, 72 F.R. 41891)

Grantor Retained Interest Trusts — Application of Sections 2036 and 2039; Hearing

Announcement 2007-81

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change of location for public hearing.

SUMMARY: This document provides a change of location for a public hearing on proposed regulations (REG-119097-05, 2007-28 I.R.B. 74) providing guidance on the portion of a trust properly includible in a grantor's gross estate under Internal Revenue Code sections 2036 and 2039 if the grantor has retained the use of property in a trust or the right to annuity, unitrust, or other income payment from such trust for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death.

DATES: The public hearing is being held on Wednesday, September 26, 2007, at 10 a.m.

ADDRESSES: The public hearing was originally being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The hearing location has changed. The public hearing will be held in room 2116, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: LaNita Van Dyke, (202) 622-3215 or Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is a notice of proposed rulemaking (REG-119097-05) that was published in the **Federal Register** on Thursday, June 7, 2007 (72 FR 31487).

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons, who submit written comments and outlines by September 5, 2007, may present oral comments at the hearing.

A period of 10 minutes is allotted to each person for presenting oral comments. The IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on August 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 21, 2007, 72 F.R. 46586)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 125.—Cafeteria Plans

26 CFR 1.125–2T: Cafeteria plan elections.

T.D. 9349

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Employee Benefits — Cafeteria Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Removal of temporary regulations.

SUMMARY: This document removes the temporary regulations pertaining to benefits that may be offered to participants under a section 125 cafeteria plan. The temporary regulations were published in the **Federal Register** on February 4, 1986. Guidance issued by the IRS and the Treasury Department under section 125 have made these temporary regulations obsolete.

DATES: *Effective Dates:* These regulations are effective August 1, 2007.

FOR FURTHER INFORMATION CONTACT: Mireille Khoury at (202) 622–6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On February 4, 1986, the IRS and Treasury Department published temporary regulations on section 125. The temporary regulations were published in the **Federal Register** (T.D. 8073, 1986–1 C.B. 45 [51 FR 4318]) as section 1.125–2T. A notice of proposed rulemaking issued under section 125 (REG–142695–05, this Bulletin) and other guidance issued by the IRS and the Treasury Department under section 125 have made these temporary regulations obsolete. The temporary regulations are removed.

Special Analyses

It has been determined that this removal of temporary regulations is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this removal of temporary regulations. This removal of temporary regulations does not impose a collection of information on small entities, thus the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the preceding temporary regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this removal of temporary regulations is Mireille Khoury, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, personnel from Treasury participated in its development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Paragraph 1. The authority citation for part 1 continues to read in part, as follows:

Authority: 26 U.S.C. 7805 * * *

§1.125–2T [Removed]

Par. 2. Section 1.125–2T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 24, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 31, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2007, 72 F.R. 41891)

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rates of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2007, will be 8 percent for overpayments (7 percent in the case of a corporation), 8 percent for underpayments, and 10 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 5.5 percent.

Rev. Rul. 2007–56

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies

during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 2007 is 5 percent. Accordingly, an overpayment rate of 8 percent (7 percent in the case of a corporation) and an underpayment rate of 8 percent are established for the calendar quarter beginning October 1, 2007. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning October 1, 2007, is 5.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 2007, is 10 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 5.5 percent, 7 percent, 8 percent, and 10 percent are published in Tables 16, 19, 21, and 25 of Rev. Proc. 95–17, 1995–1 C.B. 556, 570, 573, 575, and 579.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Wendy Kribell of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Kribell at (202) 622–4570 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 — PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — DEC. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — DEC. 31, 1998 – Continued

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PAGE
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	4%	13	567	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	5%	15	569	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	5%	15	569	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	6%	17	571	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	6%	17	571	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	6%	17	571	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	7%	19	573	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	7%	19	573	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	7%	19	573	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	7%	19	573	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	7%	19	573	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	7%	19	573	8%	21	575

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 31, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621
Jan. 1, 2005—Mar. 31, 2005	7%	19	573
Apr. 1, 2005—Jun. 30, 2005	8%	21	575
Jul. 1, 2005—Sep. 30, 2005	8%	21	575
Oct. 1, 2005—Dec. 31, 2005	9%	23	577
Jan. 1, 2006—Mar. 31, 2006	9%	23	577
Apr. 1, 2006—Jun. 30, 2006	9%	23	577
Jul. 1, 2006—Sep. 30, 2006	10%	25	579
Oct. 1, 2006—Dec. 31, 2006	10%	25	579
Jan. 1, 2007—Mar. 31, 2007	10%	25	579
Apr. 1, 2007—Jun. 30, 2007	10%	25	579
Jul. 1, 2007—Sep. 30, 2007	10%	25	579
Oct. 1, 2007—Dec. 31, 2007	10%	25	579

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574

TABLE OF INTEREST RATES FOR CORPORATE OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005—Mar. 31, 2005	2.5%	10	564
Apr. 1, 2005—Jun. 30, 2005	3.5%	12	566
Jul. 1, 2005—Sep. 30, 2005	3.5%	12	566
Oct. 1, 2005—Dec. 31, 2005	4.5%	14	568
Jan. 1, 2006—Mar. 31, 2006	4.5%	14	568
Apr. 1, 2006—Jun. 30, 2006	4.5%	14	568
Jul. 1, 2006—Sep. 30, 2006	5.5%	16	570
Oct. 1, 2006—Dec. 31, 2006	5.5%	16	570
Jan. 1, 2007—Mar. 31, 2007	5.5%	16	570
Apr. 1, 2007—Jun. 30, 2007	5.5%	16	570
Jul. 1, 2007—Sep. 30, 2007	5.5%	16	570
Oct. 1, 2007—Dec. 31, 2007	5.5%	16	570

Section 7701.—Definitions

26 CFR 301.7701–2: Business entities; definitions.

T.D. 9356

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Disregarded Entities; Employment and Excise Taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under which qualified subchapter S subsidiaries and single-owner eligible entities that currently are disregarded as entities separate from their owners for Federal tax purposes will be treated as separate entities for employment tax and related reporting requirement purposes. This document also contains final regulations that treat such disregarded entities as separate entities for purposes of certain excise taxes reported on Forms 720, *"Quarterly Federal Excise Tax Return;"* 730, "Monthly Tax Return for Wagers;" 2290, *"Heavy Highway Vehicle Use Tax Return;"* and 11–C, *"Occupational Tax and Registration Return for Wagering*;" excise tax refunds or payments claimed on Form 8849, *"Claim for Refund of Excise Taxes*;" and excise tax registrations on Form 637, *"Application for Registration (For Certain Excise Tax Activities)*." These regulations affect disregarded entities and the owners and employees of disregarded entities with respect to the payment and reporting of Federal employment taxes and the reporting of wage payments. These regulations also affect disregarded entities and their owners in the payment and reporting of certain Federal excise taxes and in registration and claims related to certain Federal excise taxes.

DATES: *Effective Date:* These regulations are effective on August 16, 2007.

Applicability Dates: With respect to employment taxes, these regulations apply to wages paid on or after January 1, 2009. With respect to excise taxes, these regulations apply to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

FOR FURTHER INFORMATION CONTACT: John Richards at (202) 622–6040 (on the employment tax provisions) or Susan Athy at (202) 622–3130 (on the excise tax provisions) (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR parts 1 and 301. On October 18, 2005, a notice of proposed rulemaking (REG–114371–05, 2005–2 C.B. 930) was published in the **Federal Register** (70 FR 60475) proposing to treat qualified subchapter S subsidiaries (QSubs) (under section 1361(b)(3)(B) of the Internal Revenue Code (Code)) and certain other single-owner eligible entities (under §§301.7701–1 through 301.7701–3 of the Procedure and Administrative Regulations) that currently are disregarded as entities separate from their owners (disregarded entities) as separate entities for purposes of employment tax and related reporting requirements and for purposes of certain excise taxes reported on Forms 720, 730, 2290, and 11–C; excise tax refunds or payments claimed on Form 8849; and excise tax registrations on Form 637. Comments addressing employment taxes were received from the public in response to the notice of proposed rulemaking. No comments were received regarding the excise tax provisions of the proposed regulations. No public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Changes Made

As provided in the proposed regulations, the final regulations provide that a disregarded entity is treated as a separate entity for purposes of employment taxes and related reporting requirements. The final regulations clarify that the separate entity is treated as a corporation for purposes of employment taxes and related reporting requirements. As provided in the proposed regulations, a disregarded entity continues to be disregarded for other Federal tax purposes. The final regulations clarify that an owner of a disregarded entity treated as a sole proprietorship is subject to taxes under the Self-Employment Contributions Act (SECA) (section 1401 *et. seq.*). Additionally, the final regulations retain the example illustrating that an individual owner of a disregarded entity continues to be treated as self-employed for purposes of SECA taxes, and not as an employee of a disregarded entity for employment tax purposes.

Commentators suggested that the proposed regulations not be finalized, and that Notice 99–6, 1999–1 C.B. 321, be retained. Notice 99–6 provides that employment taxes and other employment tax obligations with respect to employees of a disregarded entity may be satisfied in one of two ways: (1) calculation, reporting, and payment of all employment tax obligations with respect to employees of the disregarded entity by its owner (as though the employees of the disregarded entity are employed directly by the owner) and under the owner's name and taxpayer identification number; or (2) separate calculation, reporting, and payment of all employment tax obligations by each state law entity with respect to its employees under its own name and taxpayer identification number.

Commentators stated that the regulations would increase administrative burden for taxpayers that currently choose to pay and report employment taxes at the owner level as permitted by Notice 99–6. Commentators also suggested that if the regulations were finalized, complications could arise for states where state employment tax filings are required at the owner level. No written comments were received from any state. The IRS and the Treasury Department continue to believe that recognizing disregarded entities as employers for Federal employment taxes will improve administration of the Federal tax laws and simplify Federal tax compliance with respect to reporting, payment, and collection of employment taxes. In addition, because most states recognize disregarded entities as employers for reporting, payment, and collection

of state employment taxes, these regulations will more closely align Federal and state reporting, payment and collection of employment taxes. Accordingly, this comment is not adopted.

One commentator requested clarification of the applicability of section 3306(c)(8) to services performed for a disregarded entity that is owned by an organization described in section 501(c)(3). Section 3306(c)(8) provides that services performed for an organization described in section 501(c)(3) are excepted from the definition of employment for Federal Unemployment Tax Act (FUTA) purposes. Even though a disregarded entity owned by a section 501(c)(3) organization will be regarded for employment tax purposes, the disregarded entity will continue to be considered an unincorporated branch or division of the section 501(c)(3) organization for other Federal tax purposes. For example, the disregarded entity will be considered an unincorporated branch or division of the section 501(c)(3) organization for purposes of the organization's annual information reporting requirements under section 6033. See Announcement 99–102, 1999–2 C.B. 545. Because section 3306(c)(8) looks to the employer's status for income tax purposes to establish the basis for exemption from FUTA, a disregarded entity owned solely by a section 501(c)(3) organization is considered exempt from tax under section 501(c)(3) for purposes of section 3306(c)(8). Thus, a disregarded entity owned solely by a section 501(c)(3) organization will not be subject to FUTA tax on wages it pays its employees.

One commentator requested clarification of the applicability of the backup withholding provisions under section 3406 to disregarded entities. Section 3406 requires the payor of certain "reportable payments" to withhold from such payments a tax at the rate of 28 percent. For instance, if the payee where required to do so does not provide a valid taxpayer identification number (TIN) to the payor, the payor must backup withhold on reportable payments to the payee. Reportable payments are payments that must be reported to a payee on Form 1099, "*U.S. Information Return for Calendar Year 1971,*" such as certain payments for services made in the course of a trade or business. Wage payments are not reportable payments however, and are not subject to backup withholding under section 3406. These regulations do not apply to reportable payments under section 3406. Because the owner of a disregarded entity other than a QSub is required to file and furnish information returns with respect to non-wage reportable payments and that requirement is not affected by these regulations, the disregarded entity is not subject to the backup withholding requirements. Rather, the owner of the disregarded entity is responsible for any backup withholding that is required with respect to reportable payments considered made by the owner. Under section 1361(b)(3)(E) disregarded entities that are QSubs are subject to information reporting requirements on non-wage payments, unless the Secretary provides otherwise. These regulations do not address the information reporting for QSubs.

Availability of IRS Documents

The IRS notice and announcement cited in this preamble are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available at *www.irs.gov*.

Effective Date

The employment tax provisions of these regulations apply to wages paid on or after January 1, 2009. The notice of proposed rulemaking provided that these regulations would become effective with respect to wages paid on January 1 following the year of publication of these final regulations in the **Federal Register**, which would have been January 1, 2008. However, in order to ensure that taxpayers have sufficient time to make any necessary changes to their systems in response to these regulations, the IRS and the Treasury Department have determined that it is appropriate to delay the effective date of these regulations until January 1, 2009.

The IRS and the Treasury Department believe that the considerations that support a January 1, 2009, effective date for the employment tax provisions do not apply to the excise tax provisions. Thus, the excise tax provisions of these regulations apply to liabilities imposed and actions required or permitted in periods beginning on or after January 1, 2008. For periods beginning before that date, the IRS will treat payments made by a disregarded entity, or other actions taken by a disregarded entity, with respect to the excise taxes affected by these regulations as having been made or taken by the sole owner of that entity. Thus, for such periods, the owner of a disregarded entity will be treated as satisfying the owner's obligations with respect to the excise taxes affected by these regulations, provided that those obligations are satisfied either (1) by the owner itself or (2) by the disregarded entity on behalf of the owner.

Effect on Other Documents

Disregarded entities, and the owners of such entities may continue to use the procedures permitted by Notice 99–6 for wages paid prior to January 1, 2009. Notice 99–6 provides that if the owner calculates and pays all employment taxes and satisfies all other employment tax obligations with respect to employees of the disregarded entity under the owner's name and taxpayer identification number (as permitted under method (1) of Notice 99–6) for a return period that begins on or after April 20, 1999, then the owner must continue to use this method unless and until otherwise permitted by the Commissioner. However, Notice 99–6 is modified such that a taxpayer may switch to method (2) of Notice 99–6 with respect to wages paid on or after August 16, 2007, and before January 1, 2009, without seeking permission of the Commissioner. Taxpayers who switch from method (1) to method (2) with respect to wages paid prior to January 1, 2009, may consider wages paid by the owner to employees of the disregarded entity during the calendar year of the switch as having been paid by the disregarded entity for purposes of determining whether wages paid to the disregarded entity's employees have reached the contribution and benefit base as determined under section 230 of the Social Security Act and for purposes of the wage base under section 3306. However, as provided in Notice 99–6, regardless of whether the owner uses method (1) or method (2), the owner is ultimately responsible for employment tax liabilities and other employment tax responsibilities with respect to all wages paid prior to January 1, 2009, to employees of the disregarded entity.

Notice 99–6 is obsoleted as of January 1, 2009.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Susan Athy, Office of Associate Chief Counsel (Passthroughs and Special Industries), and John Richards, Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.34–1 is revised to read as follows:

§1.34–1 Special rule for owners of certain business entities.

Amounts payable under sections 6420, 6421, and 6427 to a business entity that is treated as separate from its owner under §1.1361–4(a)(8) (relating to certain qualified subchapter S subsidiaries) or §301.7701–2(c)(2)(v) of this chapter (relating to certain wholly-owned entities) are, for purposes of section 34, treated as payable to the owner of that entity.

§§1.34–2, 1.34–3, 1.34–4, 1.34–5, and 1.34–6 [Removed]

Par. 3. Sections 1.34–2, 1.34–3, 1.34–4, 1.34–5, and 1.34–6 are removed.

Par. 4. Section 1.1361–4 is amended as follows:

1. In paragraph (a)(1) introductory text, the language "Except as otherwise provided in paragraphs (a)(3) and (a)(6)" is removed, and the language "Except as otherwise provided in paragraphs (a)(3), (a)(6), (a)(7), and (a)(8)" is added in its place.

2. Paragraphs (a)(7) and (a)(8) are added.

The additions read as follows:

§1.1361–4 Effect of QSub election.

(a) * * *

(7) *Treatment of QSubs for purposes of employment taxes*—(i) *In general.* A QSub is treated as a separate corporation for purposes of Subtitle C — Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code).

(ii) *Effective/applicability date.* This paragraph (a)(7) applies with respect to wages paid on or after January 1, 2009.

(8) *Treatment of QSubs for purposes of certain excise taxes*—(i) *In general.* A QSub is treated as a separate corporation for purposes of—

(A) Federal tax liabilities imposed by Chapters 31, 32 (other than section 4181), 33, 34, 35, 36 (other than section 4461), and 38 of the Internal Revenue Code, or any floor stocks tax imposed on articles subject to any of these taxes;

(B) Collection of tax imposed by Chapter 33 of the Internal Revenue Code;

(C) Registration under sections 4101, 4222, and 4412; and

(D) Claims of a credit (other than a credit under section 34), refund, or payment related to a tax described in paragraph (a)(8)(i)(A) of this section or under section 6426 or 6427.

(ii) *Effective/applicability date.* This paragraph (a)(8) applies to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

§1.1361–6 [Amended]

Par. 5. Section 1.1361–6 is amended by removing the language "Except as provided in §§1.1361–4(a)(3)(iii), 1.1361–4(a)(5)(i), and 1.1361–5(c)(2)" and by adding the language "Except as provided in §§1.1361–4(a)(3)(iii), 1.1361–4(a)(5)(i), 1.1361–4(a)(6)(iii), 1.1361–4(a)(7)(ii), 1.1361–4(a)(8)(ii), and 1.1361–5(c)(2)" in its place.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 6. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 7. Section 301.7701–2 is amended as follows:

1. A sentence is added at the end of paragraph (a).

2. Paragraph (c)(2)(i) is revised.

3. Paragraphs (c)(2)(iv), (c)(2)(v), (e)(5), and (e)(6) are added.

The additions read as follows:

§301.7701–2 Business entities; definitions.

(a) * * * But see paragraphs (c)(2)(iv) and (v) of this section for special employment and excise tax rules that apply to an eligible entity that is otherwise disregarded as an entity separate from its owner.

* * * * *

(c) * * *

(2) *Wholly owned entities*—(i) *In general.* Except as otherwise provided in this paragraph (c), a business entity that has a single owner and is not a corporation under paragraph (b) of this section is disregarded as an entity separate from its owner.

* * * * *

(iv) *Special rule for employment tax purposes*—(A) *In general.* Paragraph (c)(2)(i) of this section (relating to certain wholly owned entities) does not apply to taxes imposed under Subtitle C — Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code). Paragraph (c)(2)(i) of this section does apply to taxes imposed under Subtitle A, including Chapter 2 — Tax on Self-Employment Income. The owner of an entity that is treated in the same manner as a sole proprietorship

under paragraph (a) of this section will be subject to the tax on self-employment income.

(B) *Treatment of entity.* An entity that is otherwise disregarded as an entity separate from its owner but for paragraph (c)(2)(iv)(A) of this section is treated as a corporation with respect to taxes imposed under Subtitle C — Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code).

(C) *Example.* The following example illustrates the application of paragraph (c)(2)(iv) of this section:

Example. (i) LLCA is an eligible entity owned by individual A and is generally disregarded as an entity separate from its owner for Federal tax purposes. However, LLCA is treated as an entity separate from its owner for purposes of subtitle C of the Internal Revenue Code. LLCA has employees and pays wages as defined in sections 3121(a), 3306(b), and 3401(a).

(ii) LLCA is subject to the provisions of subtitle C of the Internal Revenue Code and related provisions under 26 CFR subchapter C, Employment Taxes and Collection of Income Tax at Source, parts 31 through 39. Accordingly, LLCA is required to perform such acts as are required of an employer under those provisions of the Internal Revenue Code and regulations thereunder that apply. All provisions of law (including penalties) and the regulations prescribed in pursuance of law applicable to employers in respect of such acts are applicable to LLCA. Thus, for example, LLCA is liable for income tax withholding, Federal Insurance Contributions Act (FICA) taxes, and Federal Unemployment Tax Act (FUTA) taxes. See sections 3402 and 3403 (relating to income tax withholding); 3102(b) and 3111 (relating to FICA taxes), and 3301 (relating to FUTA taxes). In addition, LLCA must file under its name and EIN the applicable forms in the 94X series, for example, Form 941, "*Employer's QUARTERLY Federal Tax Return*," Form 940, "*Employer's Annual Federal Unemployment(FUTA) Tax Return*;" file with the Social Security Administration and furnish to LLCA's employees statements on Forms W-2, "*Wage and Tax Statement*;" and make timely employment tax deposits. See §§31.6011(a)–1, 31.6011(a)–3, 31.6051–1, 31.6051–2, and 31.6302–1 of this chapter.

(iii) A is self-employed for purposes of subtitle A, chapter 2, Tax on Self-Employment Income, of the Internal Revenue Code. Thus, A is subject to tax under section 1401 on A's net earnings from self-employment with respect to LLCA's activities. A is not an employee of LLCA for purposes of subtitle C of the Internal Revenue Code. Because LLCA is treated as a sole proprietorship of A for income tax purposes, A is entitled to deduct trade or business expenses paid or incurred with respect to activities carried on through LLCA, including the employer's share of employment taxes imposed under sections 3111 and 3301, on A's Form 1040, Schedule C, "*Profit or Loss From Business (Sole Proprietorship)*."

(v) *Special rule for certain excise tax purposes*—(A) *In general.* Paragraph (c)(2)(i) of this section (relating to certain wholly owned entities) does not apply for purposes of—

(*1*) Federal tax liabilities imposed by Chapters 31, 32 (other than section 4181), 33, 34, 35, 36 (other than section 4461), and 38 of the Internal Revenue Code, or any floor stocks tax imposed on articles subject to any of these taxes;

(*2*) Collection of tax imposed by Chapter 33 of the Internal Revenue Code;

(*3*) Registration under sections 4101, 4222, and 4412; and

(*4*) Claims of a credit (other than a credit under section 34), refund, or payment related to a tax described in paragraph (c)(2)(v)(A)(*1*) of this section or under section 6426 or 6427.

(B) *Example.* The following example illustrates the provisions of this paragraph (c)(2)(v):

Example. (i) LLCB is an eligible entity that has a single owner, B. LLCB is generally disregarded as an entity separate from its owner. However, under paragraph (c)(2)(v) of this section, LLCB is treated as an entity separate from its owner for certain purposes relating to excise taxes.

(ii) LLCB mines coal from a coal mine located in the United States. Section 4121 of chapter 32 of the Internal Revenue Code imposes a tax on the producer's sale of such coal. Section 48.4121–1(a) of this chapter defines a "producer" generally as the person in whom is vested ownership of the coal under state law immediately after the coal is severed from the ground. LLCB is the person that owns the coal under state law immediately after it is severed from the ground. Under paragraph (c)(2)(v)(A)(*1*) of this section, LLCB is the producer of the coal and is liable for tax on its sale of such coal under chapter 32 of the Internal Revenue Code. LLCB must report and pay tax on Form 720, "*Quarterly Federal Excise Tax Return,*" under its own name and taxpayer identification number.

(iii) LLCB uses undyed diesel fuel in an earthmover that is not registered or required to be registered for highway use. Such use is an off-highway business use of the fuel. Under section 6427(l), the ultimate purchaser is allowed to claim an income tax credit or payment related to the tax imposed on diesel fuel used in an off-highway business use. Under paragraph (c)(2)(v) of this section, for purposes of the credit or payment allowed under section 6427(l), LLCB is the person that could claim the amount on its Form 720 or on a Form 8849, "*Claim for Refund of Excise Taxes*." Alternatively, if LLCB did not claim a payment during the time prescribed in section 6427(i)(2) for making a claim under section 6427, §1.34–1 of this chapter provides that B, the owner of LLCB, could claim the income tax credit allowed under section 34 for the nontaxable use of diesel fuel by LLCB.

* * * * *

(e) * * *

(5) Paragraph (c)(2)(iv) of this section applies with respect to wages paid on or after January 1, 2009.

(6) Paragraph (c)(2)(v) of this section applies to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved July 25, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 15, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 16, 2007, 72 F.R. 45891)

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rates Update

Notice 2007–75

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II).

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for August 2007 is 6.33 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in: Month	Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
September	2007	5.86	5.27 to 5.86

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for August 2007 is 4.93 percent. The Service has determined this rate as the average of the yield on the 30-year Treasury bond maturing in February 2037 determined each day through August 8, 2007, and the yield on the 30-year Treasury bond maturing in May 2037 determined each day for the balance of the month.

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 877–829–5500 (a toll-free number), between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 202–283–9703. Mr. Montanaro may be reached at 202–283–9714. The telephone numbers in the preceding sentences are not toll-free.

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26 CFR 601.602: Tax forms and instructions.
(Also: Part I, § 179.)

Rev. Proc. 2007–60

SECTION 1. PURPOSE

This revenue procedure corrects the inflation adjusted amounts set forth in Rev. Proc. 2006–53, 2006–48 I.R.B. 996, that apply to taxpayers who elect to expense certain depreciable assets under § 179 of the Internal Revenue Code. This correction reflects statutory changes enacted subsequent to the publication of Rev. Proc. 2006–53.

SECTION 2. BACKGROUND

Prior to the enactment of the Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110–28, 121 Stat. 190 (2007) (the Act), § 179(b)(1) prescribed a $100,000 limitation (the $100,000 amount) on the aggregate cost of section 179 property that could be treated as an expense for any taxable year beginning after 2002 and before 2010. For those same taxable years, section 179(b)(2) provided that the $100,000 amount is reduced by the amount by which the cost of section 179 property placed in service during the taxable year exceeds $400,000 (the $400,000 amount). Both the $100,000 amount and the $400,000 amount were adjusted for inflation annually. For taxable years beginning in 2007, section 3.19 of Rev. Proc. 2006–53 provides that the $100,000 amount and the

$400,000 amount, adjusted for inflation, are $112,000 and $450,000, respectively.

Section 8212 of the Act changes the $100,000 amount and the $400,000 amount to $125,000 (the $125,000 amount) and $500,000 (the $500,000 amount), respectively, for taxable years beginning in 2007 through 2010. Section 8212 of the Act also provides that the $125,000 amount and the $500,000 amount will be adjusted for inflation for taxable years beginning after 2007 and before 2011.

SECTION 3. MODIFICATION OF SECTION 3.19 OF REV. PROC. 2006–53

To reflect the statutory changes made to section 179 by § 8212 of the Act, section 3.19 of Rev. Proc. 2006–53 is modified to read as follows:

.19 *Election to Expense Certain Depreciable Assets.* For taxable years beginning in 2007, under § 179(b)(1) the aggregate cost of any § 179 property a taxpayer may elect to treat as an expense cannot exceed $125,000. Under § 179(b)(2) the $125,000 limitation is reduced (but not below zero) by the amount by which the cost of § 179 property placed in service during the 2007 taxable year exceeds $500,000. For taxable years beginning after 2007 and before 2011, the $125,000 amount under § 179(b)(1) and $500,000 amount under § 179(b)(2) will be adjusted for inflation.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Section 3.19 of Rev. Proc. 2006–53 is modified and superseded.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning in 2007.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Winston H. Douglas of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Winston H. Douglas at (202) 622–4930 (not a toll-free call).

Part IV. Items of General Interest

Withdrawal of Prior Notices of Proposed Rulemaking, Notice of Proposed Rulemaking and Notice of Public Hearing

Employee Benefits — Cafeteria Plans

REG–142695–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of prior notices of proposed rulemaking, notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains new proposed regulations providing guidance on cafeteria plans. This document also withdraws the notices of proposed rulemaking relating to cafeteria plans under section 125 that were published on May 7, 1984, December 31, 1984, March 7, 1989, November 7, 1997 and March 23, 2000. In general, these proposed regulations would affect employers that sponsor a cafeteria plan, employees that participate in a cafeteria plan, and third-party cafeteria plan administrators.

DATES: Written or electronic comments must be received by November 5, 2007. Outlines of topics to be discussed at the hearing scheduled for November 15, 2007, at 10 a.m., must be received by October 25, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–142695–05), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–142695–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–142695–05). The public hearing will be held at the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Mireille T. Khoury at (202) 622–6080; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Oluwafunmilayo Taylor of the Publications and Regulations Branch at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by October 5, 2007. Comments are specifically requested concerning:

Whether the proposed collections of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automatic collection techniques or other forms of information technology; and

Estimates of the capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.125–2 (cafeteria plan elections); §1.125–6(b)–(g) (substantiation of expenses), and §1.125–7 (cafeteria plan nondiscrimination rules). This information is required to file employment tax returns and Forms W–2. The collection of information is voluntary to obtain a benefit. The likely respondents are Federal, state or local governments, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 34,000,000 hours.

Estimated average annual burden per respondent: 5 hours.

Estimated annual frequency of responses: once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed Income Tax Regulations (26 CFR Part 1) under section 125 of the Internal Revenue Code (Code). On May 7, 1984, December 31, 1984, March 7, 1989, November 7, 1997, and March 23, 2000, the IRS and Treasury Department published proposed amendments to 26 CFR Part 1 under section 125 in the **Federal Register** (EE–16–79, 1984–1 C.B. 563 [49 FR 19321], EE–16–79, 1985–1 C.B. 603 [49 FR 50733], EE–130–86, 1989–1 C.B. 944 [54 FR 9460], REG–243025–96, 1997–2 C.B. 626 [62 FR 60196] and REG–117162–99, 2000–1 C.B. 871 [65 FR 15587]). These 1984, 1989, 1997 and 2000 proposed regulations are hereby withdrawn. Also, the temporary regulations under section 125 that were published on February 4, 1986 in the **Federal Register** (T.D. 8073, 1986–1 C.B. 45 [51 FR 4318]) are being withdrawn in a separate document. The new proposed regulations that are published in this document replace those proposed regulations.

Explanation of Provisions

Overview

The new proposed regulations are organized as follows: general rules on qualified and nonqualified benefits in cafeteria plans (new proposed §1.125–1), general rules on elections (new proposed §1.125–2), general rules on flexible spending arrangements (new proposed §1.125–5), general rules on substantiation of expenses for qualified benefits (new proposed §1.125–6) and nondiscrimination rules (new proposed §1.125–7). The new proposed regulations, new Proposed §§1.125–1, 1.125–2, 1.125–5, 1.125–6 and §1.125–7, consolidate and restate Proposed §1.125–1 (1984, 1997, 2000), §1.125–2 (1989, 1997, 2000) and §1.125–2T (1986). Unless otherwise indicated, references to "new proposed regulations" or "these proposed regulations" mean the proposed section 125 regulations being published in this document.

The new proposed regulations reflect changes in tax law since the prior regulations were proposed, including: the change in the definition of dependent (section 152) and the addition of the following as qualified benefits: adoption assistance (section 137), additional deferred compensation benefits described in section 125(d)(1)(B), (C) and (D), Health Savings Accounts (HSAs) (sections 223, 125(d)(2)(D) and 4980G), and qualified HSA distributions from health FSAs (section 106(e)). Other changes include the prohibition against long-term care insurance and long-term care services (section 125(f)) and the addition of the key employee concentration test in section 125(b)(2).

The prior proposed regulations, §§1.125–1 and 1.125–2, provide the basic framework and requirements for cafeteria plans and elections under cafeteria plans. The prior proposed regulations also outlined the most significant rules for benefits under a health flexible spending arrangement (health FSA) offered by a cafeteria plan — the requirement that the maximum reimbursement be available at all times during the coverage period (the uniform coverage rule), the requirement of a 12-month period of coverage, the requirement that the health FSA only reimburse medical expenses, the requirement that all medical expenses be substantiated by a third party before reimbursement, the requirement that expenses be incurred during the period of coverage, and the prohibition against deferral of compensation (including the use-or-lose rule). The prior proposed regulations also provided guidelines for dependent care FSAs, and the application of section 125 to paid vacation days offered under a cafeteria plan. These remain substantially unchanged in the new proposed regulations, with certain clarifications. Finally, the prior proposed regulations included a number of Q & As addressing transitional issues relating to the enactment of section 125, as well as the application of the now-repealed section 89 (special nondiscrimination rules with respect to certain employee benefit plans). These provisions are omitted from the new proposed regulations.

I. *New Proposed §1.125–1—Qualified and nonqualified benefits in cafeteria plans*

Section 125 exclusive noninclusion rule

Section 125 provides that, except in the case of certain discriminatory benefits, no amount shall be included in the gross income of a participant in a cafeteria plan (as defined in section 125(d)) solely because, under the plan, the participant may choose among the benefits of the plan. The new proposed regulations clarify and amplify the general rule in the prior proposed regulations that section 125 is the exclusive means by which an employer can offer employees a choice between taxable and nontaxable benefits without the choice itself resulting in inclusion in gross income by the employees. When employees may elect between taxable and nontaxable benefits, this election results in gross income to employees, unless a specific Internal Revenue Code (Code) section (such as section 125) intervenes to prevent gross income inclusion. Thus, except for an election made through a cafeteria plan that satisfies section 125 or another specific Code section (such as section 132(f)(4)), any opportunity to elect among taxable and nontaxable benefits results in inclusion of the taxable benefit regardless of what benefit is elected and when the election is made. This interpretation of section 125 is consistent with the legislative history of section 125. The legislative history begins with the interim ERISA rules for cafeteria plans:

> Under ... ERISA, an employer contribution made before January 1, 1977, to a cafeteria plan in existence on June 27, 1974, is required to be included in an employees' gross income only to the extent that the employee actually elects taxable benefits. In the case of a plan not in existence on June 27, 1974, the employer contribution is required to be included in an employee's gross income to the extent the employee could have elected taxable benefits.

S. Rep. No. 1263, 95th Cong., 2d Sess. 74 (1978), reprinted in 1978 U.S.C.C.A.N. 6837; H.R. Rep. No. 1445, 95th Cong., 2d Sess. 63 (1978); H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess. 206 (1978).

The legislative history also provides:

> [G]enerally, employer contributions under a written cafeteria plan which permits employees to elect between taxable and nontaxable benefits are excluded from the gross income of an employee to the extent that nontaxable benefits are elected.

S. Rep. No. 1263, 95th Cong., 2d Sess. 75 (1978), reprinted in 1978 U.S.C.C.A.N. 6838; H.R. Rep. No. 1445, 95th Cong., 2d Sess. 63 (1978). See also H.R. Conf. Rep. No. 1800, 95th Cong., 2d Sess. 206 (1978).

The legislative history to the 1984 amendments to section 125 continues:

> The cafeteria plan rules of the Code provide that a participant in a nondiscriminatory cafeteria plan will not be treated as having received a taxable benefit offered under the plan solely because the participant has the opportunity, before the benefit becomes available, to choose among the taxable and nontaxable benefits under the plan.

H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1173 (1984), reprinted in 1984 U.S.C.C.A.N. 1861. See also H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. 295, reprinted in 1996 U.S.C.C.A.N. 2108.

The new proposed regulations provide that unless a plan satisfies the requirements of section 125 and the regulations, the plan is not a cafeteria plan. Reasons that a plan would fail to satisfy the section 125 requirements include: offering nonqualified benefits; not offering an election between at least one permitted taxable benefit and at least one qualified benefit; deferring compensation; failing to comply with the uniform coverage rule or use-or-lose rule; allowing employees to revoke elections or make new elections during a plan year, except as provided in §1.125–4; failing to comply with substantiation requirements; paying or reimbursing expenses incurred for qualified benefits before the effective date of the cafeteria plan or before a period of coverage; allocating experience gains (forfeitures) other than as expressly allowed in the new proposed regulations; and failing to comply with grace period rules.

Definition of a cafeteria plan

The new proposed regulations provide that a cafeteria plan is a separate written plan that complies with the requirements of section 125 and the regulations, that is maintained by an employer for employees and that is operated in compliance with the requirements of section 125 and the regulations. Participants in a cafeteria plan must be permitted to choose among at least one permitted taxable benefit (for example, cash, including salary reduction) and at least one qualified benefit. A plan offering only elections among nontaxable benefits is not a cafeteria plan. Also, a plan offering only elections among taxable benefits is not a cafeteria plan. See Rev. Rul. 2002–27, 2002–1 C.B. 925, Situation 2, see §601.601(d)(2)(ii)(*b*). Finally, a cafeteria plan must not provide for deferral of compensation, except as specifically permitted in section 125(d)(2)(B), (C), or (D).

Written plan

Section 125(d)(1) requires that a cafeteria plan be in writing. The cafeteria plan must be operated in accordance with the written plan terms. The new proposed regulations require that the written plan specifically describe all benefits, set forth the rules for eligibility to participate and the procedure for making elections, provide that all elections are irrevocable (except to the extend that the plan includes the optional change in status rules in §1.125–4), and state how employer contributions may be made under the plan (for example, salary reduction or nonelective employer contributions), the maximum amount of elective contributions, and the plan year. If the plan includes a flexible spending arrangement (FSA), the written plan must include provisions complying with the uniform coverage rule and the use-or-lose rule. Because section 125(d)(1)(A) states that a cafeteria plan is a written plan under which "all participants are employees," the new proposed regulations require that the written cafeteria plan specify that only employees may participate in the cafeteria plan. The new proposed regulations also require that all provisions of the written plan apply uniformly to all participants.

Individuals who may participate in a cafeteria plan

All participants in a cafeteria plan must be employees. See section 125(d)(1)(A). These proposed regulations provide that employees include common law employees, leased employees described in section 414(n), and full-time life insurance salesmen (as defined in section 7701(a)(20)). These proposed regulations further provide that former employees (including laid-off employees and retired employees) may participate in a plan, but a plan may not be maintained predominantly for former employees. See Rev. Rul. 82–196, 1982–2 C.B. 53; Rev. Rul. 85–121, 1985–2 C.B. 57, see §601.601(d)(2)(ii)(*b*). All employees who are treated as employed by a single employer under section 414(b), (c) or (m) are treated as employed by a single employer for purposes of section 125. See section 125(g)(4). A participant's spouse or dependents may receive benefits through a cafeteria plan although they cannot participate in the cafeteria plan.

Self-employed individuals are not treated as employees for purposes of section 125. Accordingly, the new proposed regulations make clear that sole proprietors, partners, and directors of corporations are not employees and may not participate in a cafeteria plan. In addition, the new proposed regulations clarify that 2-percent shareholders of an S corporation are not employees for purposes of section 125. The new proposed regulations provide rules for dual status individuals and individuals moving between employee and non-employee status. A self-employed individual may, however, sponsor a cafeteria plan for his or her employees.

Election between taxable and nontaxable benefits

The new proposed regulations require that a cafeteria plan offer employees an election among only permitted taxable benefits (including cash) and qualified nontaxable benefits. See section 125(d)(1)(B). For purposes of section 125, cash means cash from current compensation (including salary reduction), payment for annual leave, sick leave, or other paid time off, severance pay, property, and certain after-tax employee contributions. Distributions from qualified retirement plans are not cash or taxable benefits for purposes of section 125. See Rev. Rul. 2003–62, 2003–1 C.B. 1034 (distributions to former employees from a qualified employees' trust, applied to pay health insurance premiums, are includible in former employees' gross income under section 402), see §601.601(d)(2)(ii)(*b*).

Qualified benefits

In general, in order for a benefit to be a qualified benefit for purposes of section 125, the benefit must be excludible from employees' gross income under a specific provision of the Code and must not defer compensation, except as specifically allowed in section 125(d)(2)(B), (C) or (D). Examples of qualified benefits include the following: group-term life insurance on the life of an employee (section 79); employer-provided accident and health plans, including health flexible spending arrangements, and accidental death and dismemberment policies (sections 106 and 105(b)); a dependent care assistance program (section 129); an adoption assistance program (section 137); contributions to a section 401(k) plan; contributions to certain plans maintained by educational organizations, and contributions to HSAs. Section 125(f), (d)(2)(B), (C), (D). See Notice 97–9, 1997–1 C.B. 365 (adoption assistance), see §601.601(d)(2)(ii)(*b*); Notice 2004–2, 2004–1 C.B. 269, Q & A–33 (HSAs), see

§601.601(d)(2)(ii)(*b*). A cafeteria plan may also offer long-term and short-term disability coverage as a qualified benefit (see section 106). However, see paragraph (q) in §1.125–1 for nonqualified benefits.

Group-term life insurance

An employer may provide group-term life insurance through a combination of methods. Generally, under section 79(a), the cost of $50,000 or less of group-term life insurance on the life of an employee provided under a policy (or policies) carried directly or indirectly by an employer is excludible from the employee's gross income. (Special rules apply to key employees if the group-term life insurance plan does not satisfy the nondiscrimination rules in section 79(d)). However, if the group-term life insurance provided to an employee by an employer or employers exceeds $50,000 (taking into account all coverage provided both through a cafeteria plan and outside a cafeteria plan), the cost of coverage exceeding coverage of $50,000 is includible in the employee's gross income. For this purpose, the cost of group-term life insurance is shown in §1.79–3(d)(2), Table I (Table I). The Table I cost of the excess group-term life insurance (minus all after-tax contributions by the employee for group-term life insurance coverage) is includible in each covered employee's gross income. The new proposed regulations provide that the cost of group-term life insurance on the life of an employee, that either is less than or equal to the amount excludible from gross income under section 79(a) or provides coverage in excess of that amount, but not combined with any permanent benefit, is a qualified benefit that may be offered in a cafeteria plan. The new proposed regulations also provide that the entire amount of salary reduction and employer flex-credits for group-term life insurance coverage on the life of an employee is excludible from an employee's gross income.

The rule in the new proposed regulations differs from Notice 89–110, 1989–2 C.B. 447, see §601.601(d)(2)(ii)(*b*). Notice 89–110 provides that an employee includes in gross income the greater of the Table I cost of group-term life insurance coverage exceeding $50,000 or the employee's salary reduction and employer flex-credits for excess group-term life insurance coverage. The new proposed regulations provide instead that the employee includes in gross income the Table I cost of the excess coverage (minus all after-tax contributions by the employee for group-term life insurance coverage) and that the entire amount of salary reduction and employer flex-credits for group-term life insurance coverage on the life of the employee is excludible from the employee's gross income. As noted in this preamble, taxpayers may rely on the new proposed regulations for guidance pending the issuance of final regulations.

Employer-provided accident and health plan

Coverage under an employer-provided accident and health plan that satisfies the requirements of section 105(b) may be provided as a qualified benefit through a cafeteria plan and is excludible from employees' gross income. Section 106; §1.106–1. The nondiscrimination rules under section 105(h) apply to self-insured medical reimbursement arrangements (including health FSAs).

The new proposed regulations specifically permit a cafeteria plan (but not a health FSA) to pay or reimburse substantiated individual accident and health insurance premiums. See Rev. Rul. 61–146, 1961–2 C.B. 25, see §601.601(d)(2)(ii)(*b*). In addition, a cafeteria plan may provide for payment of COBRA premiums for an employee.

For employer-provided accident and health plans and medical reimbursement plans, the definition of dependents is the definition in section 105(b) as amended by the Working Families Tax Relief Act of 2004 (WFTRA), Public Law 108–311, section 207(9) (118 Stat. 1166) (that is, a dependent as defined in section 152, determined without regard to section 152(b)(1), (b)(2), or (d)(1)(B)). See Notice 2004–79, 2004–2 C.B. 898, see §601.601(d)(2)(ii)(*b*). For purposes of the exclusion from employees' gross income for accident and health plans and for medical reimbursement under sections 105(b) and 106, the spouse or dependent of a former employee (including a retired employee or a laid-off employee) or of a deceased employee is treated as a spouse or dependent. See Rev. Rul. 82–196, 1982–2 C.B. 53; Rev. Rul. 85–121, 1985–2 C.B. 57, see §601.601(d)(2)(ii)(*b*).

Dependent care assistance programs and adoption assistance programs

If the requirements of section 129 are satisfied, up to $5,000 of employer-provided assistance for amounts paid or incurred by employees for dependent care is excludible from employees' gross income. The new proposed regulations outline the general requirements for providing dependent care assistance programs and adoption assistance programs under section 137 through a cafeteria plan. See Notice 97–9, 1997–1 C.B. 365, section II, see §601.601(d)(2)(ii)(*b*).

Cafeteria plan year

The new proposed regulations require that a cafeteria plan year must be 12 consecutive months and must be set out in the written cafeteria plan. A short plan year (or a change in plan year resulting in a short plan year) is permitted only for a valid business purpose. A change in plan year resulting in a short plan year, for other than a valid business purpose, is disregarded. If a principal purpose of a change in plan year is to circumvent the rules of section 125, the change in plan year is ineffective.

No deferral of compensation

Qualified benefits must be current benefits. In general, a cafeteria plan may not offer benefits that defer compensation or operate to defer compensation. Section 125(d)(2)(A). In general, benefits may not be carried over to a later plan year or used in one plan year to purchase benefits to be provided in a later plan year. For example, life insurance with a cash value build-up or group-term life insurance with a permanent benefit (within the meaning of §1.79–0) defers the receipt of compensation and thus is not a qualified benefit.

The new proposed regulations clarify whether certain benefits and plan administration practices defer compensation. For example, the regulations permit an accident and health insurance policy to provide certain benefit features that apply for more than one plan year, such as reasonable lifetime limits on benefits, level premiums, premium waiver during disabil-

ity, guaranteed renewability of coverage, coverage for specified accidental injury or specific diseases, and the payment of a fixed amount per day for hospitalization. But these insurance policies must not provide an investment fund or cash value to pay premiums, and no part of the premium may be held in a separate account for any beneficiary. The new proposed regulations also provide that the following benefits and practices do not defer compensation: a long-term disability policy paying benefits over more than one plan year; reasonable premium rebates or policy dividends; certain two-year lock-in vision and dental policies; certain advance payments for orthodontia; salary reduction contributions in the last month of a plan year used to pay accident and health insurance premiums for the first month of the following plan year; reimbursement of section 213(d) expenses for durable medical equipment; and allocation of experience gains (forfeitures) among participants.

Paid time off

Under the prior proposed regulations, permitted taxable benefits included various forms of paid leave. Since the prior proposed regulations were issued, many employers have recharacterized and combined vacation days, sick leave and personal days into a single category of "paid time off." The new proposed regulations use the term "paid time off" to refer to vacation days and other types of paid leave. The new proposed regulations contain the same ordering rule for elective and nonelective paid time off as set forth in Prop. §1.125–1, Q & A–7 (1984). A plan offering an election solely between paid time off and taxable benefits is not a cafeteria plan.

Grace period

The new proposed regulations allow a written cafeteria plan to provide an optional grace period immediately following the end of each plan year, extending the period for incurring expenses for qualified benefits. A grace period may apply to one or more qualified benefits (for example, health FSA or dependent care assistance program) but in no event does it apply to paid time off or contributions to section 401(k) plans. Unused benefits or contributions for one qualified benefit may only be used to reimburse expenses incurred during the grace period for that same qualified benefit. The amount of unused benefits and contributions available during the grace period may be limited by the employer. A grace period may extend to the fifteenth day of the third month after the end of the plan year (but may be for a shorter period). Benefits or contributions not used as of the end of the grace period are forfeited under the use-or-lose rule. The grace period applies to all employees who are participants (including through COBRA), as of the last day of the plan year. Grace period rules must apply uniformly to all participants. The grace period rules in these proposed regulations are based on Notice 2005–42, 2005–1 C.B. 1204, modified in Notice 2007–22, 2007–10 I.R.B. 670, see §601.601(d)(2)(ii)(*b*), amplified in Notice 2005–86, 2005–2 C.B. 1075, amplified in Notice 2007–22, 2007–10 I.R.B. 670, see §601.601(d)(2)(ii)(*b*). For eligibility to contribute to a Health Savings Account (HSA) during a grace period, see Notice 2005–86, 2005–2 C.B. 1075, see §601.601(d)(2)(ii)(*b*). For Form W–2 reporting for unused dependent care assistance used for expenses incurred during a grace period, see Notice 2005–61, 2005–2 C.B. 607, see §601.601(d)(2)(ii)(*b*).

Contributions to section 401(k) plans through a cafeteria plan

A cafeteria plan may include contributions to a section 401(k) plan. Section 125(d)(2)(B). The new proposed regulations clarify the interactions between section 125 and section 401(k). Contributions to a section 401(k) plan expressed as a percentage of compensation are permitted. Pursuant to §1.401(k)–1(a)(3)(ii), elective contributions to a section 401(k) plan may be made through automatic enrollment (that is, when the employee does not affirmatively elect cash, the employee's compensation is reduced by a fixed percentage, which is contributed to a section 401(k) plan).

Nonqualified benefits

A cafeteria plan must not offer any of the following benefits: scholarships (section 117); employer-provided meals and lodging (section 119); educational assistance (section 127); fringe benefits (section 132); long-term care insurance. See section 125(f). Long-term care services are nonqualified benefits, H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. 296, reprinted in 1996 U.S.C.C.A.N. 2109. (An HSA funded through a cafeteria plan may, however, be used to pay premiums for long-term care insurance or for long-term care services.) The new proposed regulations clarify that contributions to Archer Medical Savings Accounts (sections 220, 106(b)), group term life insurance for an employee's spouse, child or dependent, and elective deferrals to section 403(b) plans are also nonqualified benefits. A plan offering any nonqualified benefit is not a cafeteria plan. A cafeteria plan may not offer a health FSA that provides for the carryover of unused benefits. See Notice 2002–45, 2002–2 C.B. 93, Part I; Rev. Rul. 2002–41, 2002–2 C.B. 75, see §601.601(d)(2)(ii)(*b*).

After-tax employee contributions

The new proposed regulations allow a cafeteria plan to offer after-tax employee contributions for qualified benefits or paid time off. A cafeteria plan may only offer the taxable benefits specifically permitted in the new proposed regulations. Nonqualified benefits may not be offered through a cafeteria plan, even if paid with after-tax employee contributions.

Employer contributions through salary reduction

Employees electing a qualified benefit through salary reduction are electing to forego salary and instead to receive a benefit which is excludible from gross income because it is provided by employer contributions. Section 125 provides that the employee is treated as receiving the qualified benefit from the employer in lieu of the taxable benefit. A cafeteria plan may also impose reasonable fees to administer the cafeteria plan which may be paid through salary reduction. A cafeteria plan is not required to allow employees to pay for any qualified benefit with after-tax employee contributions.

II. *New Prop. §1.125–2—Elections in cafeteria plans*

Making, revoking and changing elections

Generally, a cafeteria plan must require employees to elect annually between taxable benefits and qualified benefits. Elections must be made before the earlier of the first day of the period of coverage or when benefits are first currently available. The determination of whether a taxable benefit is currently available does not depend on whether it has been constructively received by the employee for purposes of section 451. Annual elections generally must be irrevocable and may not be changed during the plan year. However, §1.125–4 permits a cafeteria plan to provide for changes in elections based on certain changes in status. An employer that wishes to permit such changes in elections must incorporate the rules in §1.125–4 in its written cafeteria plan. These proposed regulations omit the rule in Q & A–6(b) in Prop. §1.125–2 (1989) (cessation of required contributions), because the change in status rules in §1.125–4 superseded this provision of the 1989 proposed regulations.

If HSA contributions are made through salary reduction under a cafeteria plan, employees may prospectively elect, revoke or change salary reduction elections for HSA contributions at any time during the plan year with respect to salary that has not become currently available at the time of the election.

A cafeteria plan is permitted to include an automatic election for new employees or current employees. Rev. Rul. 2002–27, 2002–1 C.B. 925, see §601.601(d)(2)(ii)(*b*). A new rule also permits a cafeteria plan to provide an optional election for new employees between cash and qualified benefits. New employees avoid gross income inclusion if they make an election within 30 days after the date of hire even if benefits provided pursuant to the election relate back to the date of hire. However, salary reduction amounts used to pay for such an election must be from compensation not yet currently available on the date of the election. Also, this special election rule for new employees does not apply to any employee who terminates employment and is rehired within 30 days after terminating employment (or who returns to employment following an unpaid leave of absence of less than 30 days).

New elections and revocations or changes in elections can be made electronically. The safe harbor for electronic elections in §1.401(a)–21 is available. Only an employee can make an election or revoke or change his or her election. An employee's spouse or dependent may not make an election under a cafeteria plan and may not revoke or change an employee's election.

III. *New Prop. §1.125–5—Flexible spending arrangements*

Overview

In general, a flexible spending arrangement (FSA) is a benefit designed to reimburse employees for expenses incurred for certain qualified benefits, up to a maximum amount not substantially in excess of the salary reduction and employer flex-credits allocated for the benefit. The maximum amount of reimbursement reasonably available must be less than five times the value of the coverage. Employer flex-credits are non-elective employer contributions that an employer makes available for every employee eligible to participate in the cafeteria plan, to be used at the employee's election only for one or more qualified benefits (but not as cash or other taxable benefits). The three types of FSAs are dependent care assistance, adoption assistance and medical care reimbursements (health FSA).

Uniform coverage rule

The new proposed regulations retain the rule that the maximum amount of reimbursement from a health FSA must be available at all times during the period of coverage (properly reduced as of any particular time for prior reimbursements). The uniform coverage rule does not apply to FSAs for dependent care assistance or adoption assistance.

Use-or-lose rule

An FSA must satisfy all the requirements of section 125, including the prohibition against deferring compensation. In general, as discussed under "No deferral of compensation", in order to satisfy this requirement of section 125, all benefits and contributions must be used by the end of the plan year (or grace period, if applicable), or are forfeited. The new proposed regulations continue the use-or-lose rule.

Period of coverage

The required period of coverage for all FSAs continues to be twelve months, with an exception for short plan years that satisfy the conditions in the new proposed regulations. The period of coverage and the plan year need not be the same. The beginning and end of a period of coverage is clarified. The new proposed regulations also clarify that FSAs for different qualified benefits need not have the same coverage period. See also "Grace period", discussed in this preamble. The new proposed regulations also continue to provide that expenses are incurred when services are provided. Expenses incurred before or after the period of coverage may not be reimbursed.

Health FSA

A health FSA may only reimburse certain substantiated section 213(d) medical care expenses incurred by the employee, or by the employee's spouse or dependents. A health FSA may be limited to a subset of permitted section 213(d) medical expenses (for example, a health FSA is permitted to exclude reimbursement of over-the-counter drugs described in Rev. Rul. 2003–102, 2003–2 C.B. 559, see §601.601(d)(2)(ii)(*b*)). Similarly, a health FSA may be an HSA-compatible limited-purpose health FSA or post-deductible health FSA. Rev. Rul. 2004–45, 2004–1 C.B. 971, see §601.601(d)(2)(ii)(*b*), amplified, Notice 2005–86, 2005–2 C.B. 1075. A health FSA may not reimburse premiums for accident and health insurance or long-term care insurance. See section 125(f).

A health FSA must satisfy all requirements of section 105(b), §§1.105–1 and 1.105–2. The section 105(h) nondiscrimination rules apply to health FSAs. All medical expenses must be substantiated before expenses are reimbursed. See *Incurring and reimbursing expenses for qualified benefits*, discussed in this preamble. The new proposed regulations also clarify when medical expenses are

incurred.[1] A cafeteria plan may limit enrollment in a health FSA to those employees who participate in the employer's accident and health plan.

Qualified HSA distributions

Section 106(e), enacted in section 302 of the Health Opportunity Patient Empowerment Act of 2006, Public Law 109–432 (120 Stat. 2922 (2006)) allows "qualified HSA distributions" from health FSAs to HSAs. Section 106(e) applies to distributions between December 20, 2006 and December 31, 2011. The proposed regulations incorporate the rules on qualified HSA distributions set forth in Notice 2007–22, 2007–10 I.R.B. 670. See §601.601(d)(2)(ii)(*b*).

Dependent care assistance after termination

A new optional rule permits an employer to reimburse a terminated employee's qualified dependent care expenses incurred after termination through a dependent care FSA, if all section 129 requirements are otherwise satisfied.

Experience gains

If an employee fails to use all contributions and benefits for a plan year before the end of the plan year (and the grace period, if applicable), those unused contributions and benefits are forfeited under the use-or-lose rule. Unused amounts are also known as experience gains. The new proposed regulations retain the forfeiture allocation rules in the 1989 proposed regulations, and clarify that the employer sponsoring the cafeteria plan may retain forfeitures, use forfeitures to defray expenses of administering the plan or allocate forfeitures among employees contributing through salary reduction on a reasonable and uniform basis.

FSA Administrative rules

Salary reduction contributions may be made at whatever interval the employer selects, including ratably over the plan year based on the employer's payroll periods or in equal installments at other regular intervals (for example, quarterly installments). These rules must apply uniformly to all participants.

IV. *New Prop. §1.125–6—Substantiation of expenses for all cafeteria plans*

Incurring and reimbursing expenses for qualified benefits

The new proposed regulations provide that only expenses for qualified benefits incurred after the later of the effective date or the adoption date of the cafeteria plan are permitted to be reimbursed under the cafeteria plan. Similarly, if a plan amendment adds a new qualified benefit, only expenses incurred after the later of the effective date or the adoption date are eligible for reimbursement.[2] This rule applies to all qualified benefits. Similarly, a cafeteria plan may pay or reimburse only expenses for qualified benefits incurred during a participant's period of coverage.

Substantiation and reimbursement of expenses for qualified benefits

The new proposed regulations provide, after an employee incurs an expense for a qualified benefit during the coverage period, the expense must first be substantiated before the expense may be paid or reimbursed. All expenses must be substantiated (substantiating only a limited number of total claims, or not substantiating claims below a certain dollar amount does not satisfy the requirements in the new proposed regulations). See §1.105–2; Rev. Rul. 2003–80; Rev. Rul. 2003–43, 2003–1 C.B. 935, see §601.601(d)(2)(ii)(*b*); Notice 2006–69, 2006–31 I.R.B. 107, Notice 2007–2, 2007–2 I.R.B. 254. FSAs for dependent care assistance and adoption assistance must follow the substantiation procedures applicable to health FSAs.

Debit cards

The new proposed regulations incorporate previously issued guidance on substantiating, paying and reimbursing expenses for section 213(d) medical care incurred at a medical care provider when payment is made with a debit card. Rev. Rul. 2003–43, 2003–1 C.B. 935, amplified, Notice 2006–69, 2006–31 I.R.B. 107, Notice 2007–2, 2007–2 I.R.B. 254; Rev. Proc. 98–25, 1998–1 C.B. 689, see §601.601(d)(2)(ii)(*b*). Among the permissible substantiation methods are copayment matches, recurring expenses, and real-time substantiation. The new proposed regulations also allow point-of-sale substantiation through matching inventory information with a list of section 213(d) medical expenses. The employer is responsible for ensuring that the inventory information approval system complies with the new regulations and with the recordkeeping requirements in section 6001. Rev. Rul. 2003–43, 2003–1 C.B. 935, amplified, Notice 2006–69, 2006–31 I.R.B. 107, Notice 2007–2, 2007–2 I.R.B. 254; Rev. Proc. 98–25, 1998–1 C.B. 689, see §601.601(d)(2)(ii)(*b*). The new proposed regulations also provide rules under which an FSA may pay or reimburse dependent care expenses using debit cards.

Pursuant to prior guidance (in Notice 2006–69, 2006–31 I.R.B. 107, amplified, Notice 2007–2, 2007–2 I.R.B. 254), for plan years beginning after December 31, 2006, the recordkeeping requirements described in paragraph (f) in §1.125–6 apply (that is, responsibility of employers relying on the inventory information approval system for health FSA debit cards to ensure that the system complies with the new proposed recordkeeping requirements, including Rev. Proc. 98–25, 1998–1 C.B. 689, Notice 2006–69, 2006–31 I.R.B. 107, amplified, Notice 2007–2, 2007–2 I.R.B. 254. For health FSA debit card transactions occurring on or before December 31, 2007, all supermarkets, grocery stores, discount stores and wholesale clubs that do not have a medical care merchant category code (as described in Rev. Rul. 2003–43,

[1] See Rev. Rul. 2005–55, 2005–2 C.B. 284, and Rev. Rul. 2005–24, 2005–1 C.B. 892, see §601.601(d)(2)(ii)(*b*) (section 105(b) exclusion only applicable to reimbursements for medical expenses incurred by employee, or by the employee's spouse or dependents); Rev. Rul. 2002–3, 2002–1 C.B. 316 (purported reimbursements to employees of health insurance premiums not paid by employees and therefore impermissible); Rev. Rul. 2002–80, 2002–2 C.B. 925, see §601.601(d)(2)(ii)(*b*) (so-called advance reimbursements and purported loans are impermissible); Rev. Rul. 2003–43, 2003–1 C.B. 935, see §601.601(d)(2)(ii)(*b*); Notice 2006–69, 2006–31 I.R.B. 107 (substantiation requirements for debit cards), amplified in Notice 2007–2, 2007–2 I.R.B. 254, see §601.601(d)(2)(ii)(*b*).

[2] See *American Family Mut. Ins. Co. v. United States*, 815 F. Supp. 1206 (W.D. Wis. 1992); *Wollenberg v. United States*, 75 F. Supp.2d 1032 (D. Neb. 1999); Rev. Rul. 2002–58, 2002–2 C.B. 541, see §601.601(d)(2)(ii)(*b*); Notice 97–9, section II (adoption assistance).

2003–1 C.B. 935, are nevertheless deemed to be an "other medical provider" as described in Rev. Rul. 2003–43. (For a list of merchant category codes, see Rev. Proc. 2004–43, 2004–2 C.B. 124.) During this time period, mail-order vendors and web-based vendors that sell prescription drugs are also deemed to be an "other medical provider" as described in Rev. Rul. 2003–43. After December 31, 2008, health FSA debit cards may not be used at stores with the Drug Stores and Pharmacies merchant category code unless (1) the store participates in the inventory information approval system described in Notice 2006–69, or (2) on a store location by store location basis, 90 percent of the store's gross receipts during the prior taxable year consisted of items which qualify as expenses for medical care under section 213(d) (including nonprescription medications described in Rev. Rul. 2003–102, 2003–2 C.B. 559). Notice 2006–69, 2006–31 I.R.B. 107, amplified, Notice 2007–2, 2007–2 I.R.B. 254.

V. *New Prop. §1.125–7—Nondiscrimination rules*

Discriminatory benefits provided to highly compensated participants and individuals and key employees are included in these employees' gross income. See section 125(b), (c). The new proposed regulations reflect changes in tax law since Prop. §1.125–1, Q & A–9 through 13 and 19 were proposed in 1984, including the key employee concentration test, statutory nontaxable benefits (enacted in the Deficit Reduction Act of 1984 (DEFRA), Public Law 98–369, section 531(b), (98 Stat. 881 (1984)), and the change in definition of dependent in WFTRA.

The new proposed regulations provide additional guidance on the cafeteria plan nondiscrimination rules, including definitions of key terms, guidance on the eligibility test and the contributions and benefits tests, descriptions of employees allowed to be excluded from testing and a safe harbor nondiscrimination test for premium-only-plans.

Specifically, the new proposed regulations define several key terms, including highly compensated individual or participant (consistent with the section 414(q) definition of highly compensated employee), officer, five percent shareholder, key employee and compensation. The new proposed regulations also provide guidance on the nondiscrimination as to eligibility requirement by incorporating some of the rules under section 410(b) (specifically the rules under §1.410(b)–4(b) and (c) dealing with reasonable classification, the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test).

The new proposed regulations also provide additional guidance on the contributions and benefits test and, unlike the prior proposed regulations, the new proposed regulations provide an objective test to determine when the actual election of benefits is discriminatory. Specifically, the new proposed regulations provide that a cafeteria plan must give each similarly situated participant a uniform opportunity to elect qualified benefits, and that highly compensated participants must not actually disproportionately elect qualified benefits. Finally, the new rules provide guidance on the safe harbor for cafeteria plans providing health benefits and create a safe harbor for premium-only-plans that satisfy certain requirements.

The example in Prop. §1.125–1, Q & A–11 (1984) is deleted because it concerns a qualified legal services plan, which is no longer a qualified benefit.

Other issues

These proposed regulations provide guidance under section 125 (26 U.S.C. 125). Other statutes may impose additional requirements (for example, the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1000), the Health Insurance Portability and Accountability Act of 1996 (HIPAA), (sections 9801–9803); and the continuation coverage requirements under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) (section 4980B).

Proposed Effective Date

With the exceptions noted in the "Effect on other documents" section of this preamble and under the "Debit cards" section of the preamble, it is proposed that these regulations apply for plan years beginning on or after January 1, 2009. Taxpayers may rely on these regulations for guidance pending the issuance of final regulations. Prior published guidance on qualified benefits under sections 79, 105, 106, 129, 137 and 223 that is affected by these proposed regulations remains applicable through the effective date of the final regulations (except as modified in "Effect on other documents" section of this preamble).

Effect on Other Documents

Notice 89–110, 1989–2 C.B. 447, see §601.601(d)(2)(ii)(*b*), states that where group-term life insurance provided to an employee by an employer exceeds $50,000, the employee includes in gross income the greater of the cost of group-term life insurance shown in §1.79–3(d)(2), Table I (Table I) on the excess coverage or the employee's salary reduction and employer flex-credits for excess coverage. Notice 89–110 is modified, effective as of the date the proposed regulations are published in the **Federal Register**.

Published guidance under §105(b) states that if any person has the right to receive cash or any other taxable or nontaxable benefit under a health FSA other than the reimbursement of section 213(d) medical expenses of the employee, employee's spouse or employee's dependents, then all distributions made from the arrangement are included in the employee's gross income, even amounts paid to reimburse medical care. See Rev. Rul. 2006–36, 2006–36 I.R.B. 353; Rev. Rul. 2005–24, 2005–1 C.B. 892; Rev. Rul. 2003–102, 2003–2 C.B. 559; Notice 2002–45, 2002–2 C.B. 93; Rev. Rul. 2002–41, 2002–2 C.B. 75; Rev. Rul. 69–141, 1969–1 C.B. 48. New section 106(e) provides that a health FSA will not fail to satisfy the requirements of sections 105 or 106 merely because the plan provides for a qualified HSA distribution. Amounts rolled into an HSA may be used for purposes other than reimbursing the section 213(d) medical expenses of the employee, spouse or dependents. Accordingly, Rev. Rul. 2006–36, Rev. Rul. 2005–24, Rev. Rul. 2003–102, Notice 2002–45, Rev. Rul. 2002–41, and Rev. Rul. 69–141 are modified with respect to qualified HSA distributions described in section 106(e). See Notice 2007–22, 2007–10 I.R.B. 670, see §601.601(d)(2)(ii)(*b*).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. It is hereby certified that the collection of information in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations will only minimally increase the burdens on small entities. The requirements under these regulations relating to maintaining a section 125 cafeteria plan are a minimal additional burden independent of the burdens encompassed under existing rules for underlying employee benefit plans, which exist whether or not the benefits are provided through a cafeteria plan. In addition, most small entities that will maintain cafeteria plans already use a third-party plan administrator to administer the cafeteria plan. The collection of information required in these regulations, which is required to comply with the existing substantiation requirements of sections 105, 106, 129 and 125, and the recordkeeping requirements of section 6001, will only minimally increase the third-party administrator's burden with respect to the cafeteria plan. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this proposed regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. In addition, comments are requested on the following issues:

1. Whether, consistent with section 125 of the Internal Revenue Code, multiple employers (other than members of a controlled group described in section 125(g)(4)) may sponsor a single cafeteria plan;
2. Whether salary reduction contributions may be based on employees' tips and how that would work;
3. For cafeteria plans adopting the change in status rules in §1.125–4, when a participant has a change in status and changes his or her salary reduction amount, how should the participant's uniform coverage amount be computed after the change in status.

All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 15, 2007, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the amount of time to be devoted to each topic (a signed original and eight (8) copies) by October 25, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Mireille T. Khoury, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), Internal Revenue Service. However, personnel from other offices of the IRS and Treasury Department participated in their development.

* * * * *

Withdrawal of Proposed Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (EE–16–79) that was published in the **Federal Register** on Monday, May 7, 1984 (49 FR 19321), and Monday, December 31, 1984 (49 FR 50733), the notice of proposed rulemaking (EE–130–86) that was published in the **Federal Register** on Tuesday, March 7, 1989 (54 FR 9460), and Friday, November 7, 1997 (62 FR 60196) and the notice of proposed rulemaking (REG–117162–99) that was published in the **Federal Register** on Thursday, March 23, 2000 (65 FR 15587) are withdrawn.

Proposed Amendment to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Sections 1.125–0, 1.125–1 and 1.125–2 are added to read as follows:

§1.125–0 Table of contents.

This section lists captions contained in §§1.125–1, 1.125–2, 1.125–5, 1.125–6 and §1.125–7.

§1.125–1 Cafeteria plans; general rules.

(a) Definitions.
(b) General rules.
(c) Written plan requirements.
(d) Plan year requirements.
(e) Grace period.
(f) Run-out period.
(g) Employee for purpose of Section 125.
(h) After-tax employee contributions.
(i) Prohibited taxable benefits.
(j) Coordination with other rules.
(k) Group-term life insurance.
(l) COBRA premiums.

(m) Payment or reimbursement of employees' individual accident and health insurance premiums.

(n) Section 105 rules for accident and health plan offered through a cafeteria plan.

(o) Prohibition against deferred compensation.

(p) Benefits relating to more than one year.

(q) Nonqualified benefits.

(r) Employer contributions to a cafeteria plan.

(s) Effective/applicability date.

§1.125–2 Cafeteria plans; elections.

(a) Rules relating to making elections and revoking elections.

(b) Automatic elections.

(c) Election rules for salary reduction contributions to HSAs.

(d) Optional election for new employees.

(e) Effective/applicability date.

§1.125–5 Flexible spending arrangements.

(a) Definition of flexible spending arrangement.

(b) Flex-credits allowed.

(c) Use-or-lose rule.

(d) Uniform coverage rules applicable to health FSAs.

(e) Required period of coverage for a health FSA, dependent care FSA and adoption assistance FSA.

(f) Coverage on a month-by-month or expense-by-expense basis prohibited.

(g) FSA administrative practices.

(h) Qualified benefits permitted to be offered through a FSA.

(i) Section 129 rules for dependent care assistance program offered through a cafeteria plan.

(j) Section 137 rules for adoption assistance program offered through a cafeteria plan.

(k) FSAs and the rules governing the tax-favored treatment of employer-provided health benefits.

(l) Section 105(h) requirements.

(m) HSA-compatible FSAs- limited-purpose health FSAs and post-deductible health FSAs.

(n) Qualified HSA distributions.

(o) FSA experience gains or forfeitures.

(p) Effective/applicability date.

§1.125–6 Substantiation of expenses for all cafeteria plans.

(a) Cafeteria plan payments and reimbursements.

(b) Rules for claims substantiation for cafeteria plans.

(c) Debit cards — overview.

(d) Mandatory rules for all debit cards usable to pay or reimburse medical expenses.

(e) Substantiation of expenses incurred at medical care providers and certain other stores with Drug Stores and Pharmacies merchant category code.

(f) Inventory information approval system.

(g) Debit cards used to pay or reimburse dependent care assistance.

(h) Effective/applicability date.

§1.125–7 Cafeteria plan nondiscrimination rules.

(a) Definitions.

(b) Nondiscrimination as to eligibility.

(c) Nondiscrimination as to contributions and benefits.

(d) Key employees.

(e) Section 125(g)(2) safe harbor for cafeteria plans providing health benefits.

(f) Safe harbor test for premium-only-plans.

(g) Permissive disaggregation for nondiscrimination testing.

(h) Optional aggregation of plans for nondiscrimination testing.

(i) Employees of certain controlled groups.

(j) Time to perform nondiscrimination testing.

(k) Discrimination in actual operation prohibited.

(l) Anti-abuse rule.

(m) Tax treatment of benefits in a cafeteria plan.

(n) Employer contributions to employees' Health Savings Accounts.

(o) Effective/applicability date.

§1.125–1 Cafeteria plans; general rules.

(a) *Definitions.* The definitions set forth in this paragraph (a) apply for purposes of section 125 and the regulations.

(1) The term *cafeteria plan* means a separate written plan that complies with the requirements of section 125 and the regulations, that is maintained by an employer for the benefit of its employees and that is operated in compliance with the requirements of section 125 and the regulations. All participants in a cafeteria plan must be employees. A cafeteria plan must offer at least one permitted taxable benefit (as defined in paragraph (a)(2) of this section) and at least one qualified benefit (as defined in paragraph (a)(3) of this section). A cafeteria plan must not provide for deferral of compensation (except as specifically permitted in paragraph (o) of this section).

(2) The term *permitted taxable benefit* means cash and certain other taxable benefits treated as cash for purposes of section 125. For purposes of section 125, *cash* means cash compensation (including salary reduction), payments for annual leave, sick leave, or other paid time off and severance pay. A distribution from a trust described in section 401(a) is not cash for purposes of section 125. *Other taxable benefits treated as cash* for purposes of section 125 are:

(i) Property;

(ii) Benefits attributable to employer contributions that are currently taxable to the employee upon receipt by the employee; and

(iii) Benefits purchased with after-tax employee contributions, as described in paragraph (h) of this section.

(3) *Qualified benefit.* Except as otherwise provided in section 125(f) and paragraph (q) of this section, the term *qualified benefit* means any benefit attributable to employer contributions to the extent that such benefit is not currently taxable to the employee by reason of an express provision of the Internal Revenue Code (Code) and which does not defer compensation (except as provided in paragraph (o) of this section). The following benefits are qualified benefits that may be offered under a cafeteria plan and are excludible from employees' gross income when provided in accordance with the applicable provisions of the Code—

(A) Group-term life insurance on the life of an employee in an amount that is less than or equal to the $50,000 excludible from gross income under section 79(a), but not combined with any permanent benefit within the meaning of §1.79–0;

(B) An accident and health plan excludible from gross income under section

105 or 106, including self-insured medical reimbursement plans (such as health FSAs described in §1.125–5);

(C) Premiums for COBRA continuation coverage (if excludible under section 106) under the accident and health plan of the employer sponsoring the cafeteria plan or premiums for COBRA continuation coverage of an employee of the employer sponsoring the cafeteria plan under an accident and health plan sponsored by a different employer;

(D) An accidental death and dismemberment insurance policy (section 106);

(E) Long-term or short-term disability coverage (section 106);

(F) Dependent care assistance program (section 129);

(G) Adoption assistance (section 137);

(H) A qualified cash or deferred arrangement that is part of a profit-sharing plan or stock bonus plan, as described in paragraph (o)(3) of this section (section 401(k));

(I) Certain plans maintained by educational organizations (section 125(d)(2)(C) and paragraph (o)(3)(iii) of this section); and

(J) Contributions to Health Savings Accounts (HSAs) (sections 223 and 125(d)(2)(D)).

(4) *Dependent*. The term *dependent* generally means a dependent as defined in section 152. However, the definition of dependent is modified to conform with the underlying Code section for the qualified benefit. For example, for purposes of a benefit under section 105, the term dependent means a dependent as defined in section 152, determined without regard to section 152(b)(1), (b)(2) or (d)(1)(B).

(5) *Premium-only-plan*. A *premium-only-plan* is a cafeteria plan that offers as its sole benefit an election between cash (for example, salary) and payment of the employee share of the employer-provided accident and health insurance premium (excludible from the employee's gross income under section 106).

(b) *General rules*—(1) *Cafeteria plans*. Section 125 is the exclusive means by which an employer can offer employees an election between taxable and nontaxable benefits without the election itself resulting in inclusion in gross income by the employees. Section 125 provides that cash (including certain taxable benefits) offered to an employee through a nondiscriminatory cafeteria plan is not includible in the employee's gross income merely because the employee has the opportunity to choose among cash and qualified benefits (within the meaning of section 125(e)) through the cafeteria plan. Section 125(a), (d)(1). However, if a plan offering an employee an election between taxable benefits (including cash) and nontaxable qualified benefits does not meet the section 125 requirements, the election between taxable and nontaxable benefits results in gross income to the employee, regardless of what benefit is elected and when the election is made. An employee who has an election among nontaxable benefits and taxable benefits (including cash) that is not through a cafeteria plan that satisfies section 125 must include in gross income the value of the taxable benefit with the greatest value that the employee could have elected to receive, even if the employee elects to receive only the nontaxable benefits offered. The amount of the taxable benefit is includible in the employee's income in the year in which the employee would have actually received the taxable benefit if the employee had elected such benefit. This is the result even if the employee's election between the nontaxable benefits and taxable benefits is made prior to the year in which the employee would actually have received the taxable benefits. See paragraph (q) in §1.125–1 for nonqualified benefits.

(2) *Nondiscrimination rules for qualified benefits*. Accident and health plan coverage, group-term life insurance coverage, and benefits under a dependent care assistance program or adoption assistance program do not fail to be qualified benefits under a cafeteria plan merely because they are includible in gross income because of applicable nondiscrimination requirements (for example, sections 79(d), 105(h),129(d), 137(c)(2)). See also §§1.105–11(k) and 1.125–7.

(3) *Examples*. The following examples illustrate the rules of paragraph (b)(1) of this section.

Example 1. Distributions from qualified pension plan used for health insurance premiums. (i) Employer A maintains a qualified section 401(a) retirement plan for employees. Employer A also provides accident and health insurance (as described in section 106) for employees and former employees, their spouses and dependents. The health insurance premiums are partially paid through a cafeteria plan. None of Employer A's employees are public safety officers. Employer A's health plan allows former employees to elect to have distributions from the qualified retirement plan applied to pay for the health insurance premiums through the cafeteria plan.

(ii) Amounts distributed from the qualified retirement plan which the former employees elect to have applied to pay health insurance premiums through the cafeteria plan are includible in their gross income. The same result occurs if distributions from the qualified retirement plan are applied directly to reimburse section 213(d) medical care expenses incurred by a former employee or his or her spouse or dependents. These distributions are includible in their income, and are not cash for purposes of section 125. The plan is not a cafeteria plan with respect to former employees.

Example 2. Severance pay used to pay COBRA premiums. Employer B maintains a cafeteria plan, which offers employees an election between cash and employer-provided accident and health insurance (excludible from employees' gross income under section 106). Employer B pays terminating employees severance pay. The cafeteria plan also allows a terminating employee to elect between receiving severance pay and using the severance pay to pay the COBRA premiums for the accident and health insurance. These provisions in the cafeteria plan are consistent with the requirements in section 125.

(4) *Election by participants*. (i) *In general*. A cafeteria plan must offer participants the opportunity to elect between at least one permitted taxable benefit and at least one qualified benefit. For example, if employees are given the opportunity to elect only among two or more nontaxable benefits, the plan is not a cafeteria plan. Similarly, a plan that only offers the election among salary, permitted taxable benefits, paid time off or other taxable benefits is not a cafeteria plan. See section 125(a), (d). See §1.125–2 for rules on elections.

(ii) *Premium-only-plan*. A cafeteria plan may be a premium-only-plan.

(iii) *Examples*. The following examples illustrate the rules of paragraph (b)(4)(i) of this section.

Example 1. No election. Employer C covers all its employees under its accident and health plan (excludible from employees' gross income under section 106). Coverage is mandatory (that is, employees have no election between cash and the Employer C's accident and health plan). This plan is not a cafeteria plan, because the plan offers employees no election between taxable and nontaxable benefits. The accident and health coverage is excludible from employees' gross income.

Example 2. Election between cash and at least one qualified benefit. Employer D offers its employees a plan with an election between cash and an employer-provided accident and health plan (excludible from employees' gross income under section 106). If the plan also satisfies all the other requirements of section 125, the plan is a cafeteria plan because it offers an election between at least one taxable benefit and at least one nontaxable qualified benefit.

Example 3. Election between employer flex-credits and qualified benefits. Employer E offers its employees an election between an employer flex-credit (as defined in paragraph (b) in §1.125–5) and qualified benefits. If an employee does not elect to apply the entire employer flex-credit to qualified benefits, the employee will receive no cash or other taxable benefit for the unused employer flex-credit. The plan is not a cafeteria plan because it does not offer an election between at least one taxable benefit and at least one nontaxable qualified benefit.

Example 4. No election between cash and qualified benefits for certain employees. (i) Employer F maintains a calendar year plan offering employer-provided accident and health insurance coverage which includes employee-only and family coverage options.

(ii) The plan provides for an automatic enrollment process when a new employee is hired, or during the annual election period under the plan: only employees who certify that they have other health coverage are permitted to elect to receive cash. Employees who cannot certify are covered by the accident and health insurance on a mandatory basis. Employer F does not otherwise request or collect information from employees regarding other health coverage as part of the enrollment process. If the employee has a spouse or child, the employee can elect between cash and family coverage.

(iii) When an employee is hired, the employee receives a notice explaining the plan's automatic enrollment process. The notice includes the salary reduction amounts for employee-only coverage and family coverage, procedures for certifying whether the employee has other health coverage, elections for family coverage, information on the time by which a certification or election must be made, and the period for which a certification or election will be effective. The notice is also given to each current employee before the beginning of each plan year, (except that the notice for a current employee includes a description of the employee's existing coverage, if any).

(iv) For a new employee, an election to receive cash or to have family coverage is effective if made when the employee is hired. For a current employee, an election is effective if made prior to the start of each calendar year or under any other circumstances permitted under §1.125–4. An election for any prior year carries over to the next succeeding plan year unless changed. Certification that the employee has other health coverage must be made annually.

(v) Contributions used to purchase employer-provided accident and health coverage under section 125 are not includible in an employee's gross income if the employee can elect cash. Section 125 does not apply to the employee-only coverage of an employee who cannot certify that he or she has other health coverage and, therefore, does not have the ability to elect cash in lieu of health coverage.

(5) *No deferred compensation.* Except as provided in paragraph (o) of this section, in order for a plan to be a cafeteria plan, the qualified benefits and the permitted taxable benefits offered through the cafeteria plan must not defer compensation. For example, a cafeteria plan may not provide for retirement health benefits for current employees beyond the current plan year or group-term life insurance with a permanent benefit, as defined under §1.79–0.

(c) *Written plan requirements*—(1) *General rule.* A cafeteria plan must contain in writing the information described in this paragraph (c), and depending on the qualified benefits offered in the plan, may also be required to contain additional information described in paragraphs (c)(2) and (c)(3) of this section. The cafeteria plan must be adopted and effective on or before the first day of the cafeteria plan year to which it relates. The terms of the plan must apply uniformly to all participants. The cafeteria plan document may be comprised of multiple documents. The written cafeteria plan must contain all of the following information—

(i) A specific description of each of the benefits available through the plan, including the periods during which the benefits are provided (the periods of coverage);

(ii) The plan's rules governing participation, and specifically requiring that all participants in the plan be employees;

(iii) The procedures governing employees' elections under the plan, including the period when elections may be made, the periods with respect to which elections are effective, and providing that elections are irrevocable, except to the extent that the optional change in status rules in §1.125–4 are included in the cafeteria plan;

(iv) The manner in which employer contributions may be made under the plan, (for example, through an employee's salary reduction election or by nonelective employer contributions (that is, flex-credits, as defined in paragraph (b) in §1.125–5) or both);

(v) The maximum amount of employer contributions available to any employee through the plan, by stating:

(A) The maximum amount of elective contributions (*i.e.*, salary reduction) available to any employee through the plan, expressed as a maximum dollar amount or a maximum percentage of compensation or the method for determining the maximum dollar amount; and

(B) For contributions to section 401(k) plans, the maximum amount of elective contributions available to any employee through the plan, expressed as a maximum dollar amount or maximum percentage of compensation that may be contributed as elective contributions through the plan by employees.

(vi) The plan year of the cafeteria plan;

(vii) If the plan offers paid time off, the required ordering rule for use of nonelective and elective paid time off in paragraph (o)(4) of this section;

(viii) If the plan includes flexible spending arrangements (as defined in §1.125–5(a)), the plan's provisions complying with any additional requirements for those FSAs (for example, the uniform coverage rule and the use-or-lose rules in paragraphs (d) and (c) in §1.125–5);

(ix) If the plan includes a grace period, the plan's provisions complying with paragraph (e) of this section; and

(x) If the plan includes distributions from a health FSA to employees' HSAs, the plan's provisions complying with paragraph (n) in §1.125–5.

(2) *Additional requirements under sections 105(h), 129, and 137.* A written plan is required for self-insured medical reimbursement plans (§1.105–11(b)(1)(i)), dependent care assistance programs (section 129(d)(1)), and adoption assistance (section 137(c)). Any of these plans or programs offered through a cafeteria plan that satisfies the written plan requirement in this paragraph (c) for the benefits under these plans and programs also satisfies the written plan requirements in §1.105–11(b)(1)(i), section 129(d)(1), and section 137(c) (whichever is applicable). Alternatively, a self-insured medical reimbursement plan, a dependent care assistance program, or an adoption assistance program is permitted to satisfy the requirements in §1.105–11(b)(1)(i), section 129(d)(1), or section 137(c) (whichever is applicable) through a separate written plan, and not as part of the written cafeteria plan.

(3) *Additional requirements under section 401(k).* See §1.401(k)–1(e)(7) for additional requirements that must be satisfied in the written plan if the plan offers deferrals into a section 401(k) plan.

(4) *Cross-reference allowed.* In describing the benefits available through the cafeteria plan, the written cafeteria plan need not be self-contained. For example, the written cafeteria plan may incorporate by reference benefits offered through other *separate written plans*, such as a section 401(k) plan, or coverage under a dependent care assistance program (section 129),

without describing in full the benefits established through these other plans. But, for example, if the cafeteria plan offers different maximum levels of coverage for dependent care assistance programs, the descriptions in the separate written plan must specify the available maximums.

(5) *Amendments to cafeteria plan.* Any amendment to the cafeteria plan must be in writing. A cafeteria plan is permitted to be amended at any time during a plan year. However, the amendment is only permitted to be effective for periods after the later of the adoption date or effective date of the amendment. For an amendment adding a new benefit, the cafeteria plan must pay or reimburse only those expenses for new benefits incurred after the later of the amendment's adoption date or effective date.

(6) *Failure to satisfy written plan requirements.* If there is no written cafeteria plan, or if the written plan fails to satisfy any of the requirements in this paragraph (c) (including cross-referenced requirements), the plan is not a cafeteria plan and an employee's election between taxable and nontaxable benefits results in gross income to the employee.

(7) *Operational failure*—(i) *In general.* If the cafeteria plan fails to operate according to its written plan or otherwise fails to operate in compliance with section 125 and the regulations, the plan is not a cafeteria plan and employees' elections between taxable and nontaxable benefits result in gross income to the employees.

(ii) *Failure to operate according to written cafeteria plan or section 125.* Examples of failures resulting in section 125 not applying to a plan include the following—

(A) Paying or reimbursing expenses for qualified benefits incurred before the later of the adoption date or effective date of the cafeteria plan, before the beginning of a period of coverage or before the later of the date of adoption or effective date of a plan amendment adding a new benefit;

(B) Offering benefits other than permitted taxable benefits and qualified benefits;

(C) Operating to defer compensation (except as permitted in paragraph (o) of this section);

(D) Failing to comply with the uniform coverage rule in paragraph (d) in §1.125–5;

(E) Failing to comply with the use-or-lose rule in paragraph (c) in §1.125–5;

(F) Allowing employees to revoke elections or make new elections, except as provided in §1.125–4 and paragraph (a) in §1.125–2;

(G) Failing to comply with the substantiation requirements of §1.125–6;

(H) Paying or reimbursing expenses in an FSA other than expenses expressly permitted in paragraph (h) in §1.125–5;

(I) Allocating experience gains other than as expressly permitted in paragraph (o) in §1.125–5;

(J) Failing to comply with the grace period rules in paragraph (e) of this section; or

(K) Failing to comply with the qualified HSA distribution rules in paragraph (n) in §1.125–5.

(d) *Plan year requirements*—(1) *Twelve consecutive months.* The plan year must be specified in the cafeteria plan. The plan year of a cafeteria plan must be twelve consecutive months, unless a short plan year is allowed under this paragraph (d). A plan year is permitted to begin on any day of any calendar month and must end on the preceding day in the immediately following year (for example, a plan year that begins on October 15, 2007, must end on October 14, 2008). A calendar year plan year is a period of twelve consecutive months beginning on January 1 and ending on December 31 of the same calendar year. A plan year specified in the cafeteria plan is effective for the first plan year of a cafeteria plan and for all subsequent plan years, unless changed as provided in paragraph (d)(2) of this section.

(2) *Changing plan year.* The plan year is permitted to be changed only for a valid business purpose. A change in the plan year is not permitted if a principal purpose of the change in plan year is to circumvent the rules of section 125 or these regulations. If a change in plan year does not satisfy this subparagraph, the attempt to change the plan year is ineffective and the plan year of the cafeteria plan remains the same.

(3) *Short plan year.* A short plan year of less than twelve consecutive months is permitted for a valid business purpose.

(4) *Examples.* The following examples illustrate the rules in paragraph (d) of this section:

Example 1. Employer with calendar year. Employer G, with a calendar taxable year, first establishes a cafeteria plan effective July 1, 2009. The cafeteria plan specifies a calendar plan year. The first cafeteria plan year is the period beginning on July 1, 2009, and ending on December 31, 2009. Employer G has a business purpose for a short first cafeteria plan year.

Example 2. Employer changes insurance carrier. Employer H establishes a cafeteria plan effective January 1, 2009, with a calendar year plan year. The cafeteria plan offers an accident and health plan through Insurer X. In March 2010, Employer H contracts to provide accident and health insurance through another insurance company, Y. Y's accident and health insurance is offered on a July 1-June 30 benefit year. Effective July 1, 2010, Employer H amends the plan to change to a July 1-June 30 plan year. Employer H has a business purpose for changing the cafeteria plan year and for the short plan year ending June 30, 2010.

(5) *Significance of plan year.* The plan year generally is the coverage period for benefits provided through the cafeteria plan to which annual elections for these benefits apply. Benefits elected pursuant to the employee's election for a plan year generally may not be carried forward to subsequent plan years. However, see the grace period rule in paragraph (e) of this section.

(e) *Grace period*—(1) *In general.* A cafeteria plan may, at the employer's option, include a grace period of up to the fifteenth day of the third month immediately following the end of each plan year. If a cafeteria plan provides for a grace period, an employee who has unused benefits or contributions relating to a qualified benefit (for example, health flexible spending arrangement (health FSA) or dependent care assistance) from the immediately preceding plan year, and who incurs expenses for that same qualified benefit during the grace period, may be paid or reimbursed for those expenses from the unused benefits or contributions as if the expenses had been incurred in the immediately preceding plan year. A grace period is available for all qualified benefits described in paragraph (a)(3) of this section, except that the grace period does not apply to paid time off and elective contributions under a section 401(k) plan. The effect of the grace period is that the employee may have as long as 14 months and 15 days (that is, the 12 months in the current cafeteria plan year plus the grace period) to use the benefits or contributions for a plan year before those amounts are *forfeited* under the *use-or-lose* rule in paragraph (c) in §1.125–5. If the

grace period is added to a cafeteria plan through an amendment, all requirements in paragraph (c) of this section must be satisfied.

(2) *Grace period optional features.* A grace period provision may contain any or all of the following—

(i) The grace period may apply to some qualified benefits described in paragraph (a)(3) of this section, but not to others;

(ii) The grace period provision may limit the amount of unused benefits or contributions available during the grace period. The limit must be uniform and apply to all participants. However, the limit must not be based on a percentage of the amount of the unused benefits or contributions remaining at the end of the immediately prior plan year;

(iii) The last day of the grace period may be sooner than the fifteenth day of the third month immediately following the end of the plan year (that is, the grace period may be shorter than two and one half months);

(iv) The grace period provision is permitted to treat expenses for qualified benefits incurred during the grace period either as expenses incurred during the immediately preceding plan year or as expenses incurred during the current plan year (for example, the plan may first apply the unused contributions or benefits from the immediately preceding year to pay or reimburse grace period expenses and then, when the unused contributions and benefits from the prior year are exhausted, the grace period expenses may be paid from current year contributions and benefits.); and

(v) The grace period provision may permit the employer to defer the allocation of expenses described in paragraph (e)(2)(iv) of this section until after the end of the grace period.

(3) *Grace period requirements.* A grace period must satisfy the requirements in paragraph (c) of this section and all of the following requirements:

(i) The grace period provisions in the cafeteria plan (including optional provisions in paragraph (e)(2) of this section) must apply uniformly to all participants in the cafeteria plan, determined as of the last day of the plan year. Participants in the cafeteria plan through COBRA and participants who were participants as of the last day of the plan year but terminate during the grace period are participants for purposes of the grace period. See §54.4980B–2, Q & A–8 of this chapter;

(ii) The grace period provision in the cafeteria plan must state that unused benefits or contributions relating to a particular qualified benefit may only be used to pay or reimburse expenses incurred with respect to the same qualified benefit. For example, unused amounts elected to pay or reimburse medical expenses in a health FSA may not be used to pay or reimburse dependent care expenses incurred during the grace period; and

(iii) The grace period provision in the cafeteria plan must state that to the extent any unused benefits or contributions from the immediately preceding plan year exceed the expenses for the qualified benefit incurred during the grace period, those remaining unused benefits or contributions may not be carried forward to any subsequent period (including any subsequent plan year), cannot be cashed-out and must be forfeited under the use-or-lose rule. See paragraph (c) in §1.125–5.

(4) *Examples.* The following examples illustrate the rules in this paragraph (e).

Example 1. Expenses incurred during grace period and immediately following plan year. (i) Employer I's calendar year cafeteria plan includes a grace period allowing all participants to apply unused benefits or contributions remaining at the end of the plan year to qualified benefits incurred during the grace period immediately following that plan year. The grace period for the plan year ending December 31, 2009, ends on March 15, 2010.

(ii) Employee X timely elected salary reduction of $1,000 for a health FSA for the plan year ending December 31, 2009. As of December 31, 2009, X has $200 remaining unused in his health FSA. X timely elected salary reduction for a health FSA of $1,500 for the plan year ending December 31, 2010.

(iii) During the grace period from January 1 through March 15, 2010, X incurs $300 of unreimbursed medical expenses (as defined in section 213(d)). The unused $200 from the plan year ending December 31, 2009, is applied to pay or reimburse $200 of X's $300 of medical expenses incurred during the grace period. Therefore, as of March 16, 2010, X has no unused benefits or contributions remaining for the plan year ending December 31, 2009.

(iv) The remaining $100 of medical expenses incurred between January 1 and March 15, 2010, is paid or reimbursed from X's health FSA for the plan year ending December 31, 2010. As of March 16, 2010, X has $1,400 remaining in the health FSA for the plan year ending December 31, 2010.

Example 2. Unused benefits exceed expenses incurred during grace period. Same facts as *Example 1*, except that X incurs $150 of section 213(d) medical expenses during the grace period (January 1 through March 15, 2010). As of March 16, 2010, X has $50 of unused benefits or contributions remaining for the plan year ending December 31, 2009. The unused $50 cannot be cashed-out, converted to any other taxable or nontaxable benefit, or used in any other plan year (including the plan year ending December 31, 2009). The unused $50 is subject to the use-or-lose rule in paragraph (c) in §1.125–5 and is forfeited. As of March 16, 2010, X has the entire $1,500 elected in the health FSA for the plan year ending December 31, 2010.

Example 3. Terminated participants. (i) Employer J's cafeteria plan includes a grace period allowing all participants to apply unused benefits or contributions remaining at the end of the plan year to qualified benefits incurred during the grace period immediately following that plan year. For the plan year ending on December 31, 2009, the grace period ends March 15, 2010.

(ii) Employees A, B, C, and D each timely elected $1,200 salary reduction for a health FSA for the plan year ending December 31, 2009. Employees A and B terminated employment on September 15, 2009. Each has $500 of unused benefits or contributions in the health FSA.

(iii) Employee A elected COBRA for the health FSA. Employee A is a participant in the cafeteria plan as of December 31, 2009, the last day of the 2009 plan year. Employee A has $500 of unused benefits or contributions available during the grace period for the 2009 plan year (ending March 15, 2010).

(iv) Employee B did not elect COBRA for the health FSA. Employee B is not a participant in the cafeteria plan as of December 31, 2009. The grace period does not apply to Employee B.

(v) Employee C has $500 of unused benefits in his health FSA as of December 31, 2009, and terminated employment on January 15, 2010. Employee C is a participant in the cafeteria plan as of December 31, 2009 and has $500 of unused benefits or contributions available during the grace period ending March 15, 2010, even though he terminated employment on January 15, 2010.

(vi) Employee D continues to work for Employer H throughout 2009 and 2010, also has $500 of unused benefits or contributions in his health FSA as of December 31, 2009, but made no health FSA election for 2010. Employee D is a participant in the cafeteria plan as of December 31, 2009 and has $500 of unused benefits or contributions available during the grace period ending March 15, 2010, even though he is not a participant in a health FSA for the 2010 plan year.

(f) *Run-out period.* A cafeteria plan is permitted to contain a run-out period as designated by the employer. A run-out period is a period after the end of the plan year (or grace period) during which a participant can submit a claim for reimbursement for a qualified benefit incurred during the plan year (or grace period). Thus, a plan is also permitted to provide a deadline on or after the end of the plan year (or grace period) for submitting a claim for reimbursement for the plan year. Any run-out period must be provided on a uniform and

consistent basis with respect to all participants.

(g) *Employee for purposes of section 125*—(1) *Current employees, former employees.* The term employee includes any current or former employee (including any laid-off employee or retired employee) of the employer. See paragraph (g)(3) of this section concerning limits on participation by former employees. Specifically, the term *employee* includes the following—

(i) Common law employee;

(ii) Leased employee described in section 414(n);

(iii) Full-time life insurance salesman (as defined in section 7701(a)(20)); and

(iv) A current employee or former employee described in paragraphs (g)(1)(i) through (iii) of this section.

(2) *Self-employed individual not an employee.* (i) *In general.* The term *employee* does not include a self-employed individual or a 2-percent shareholder of an S corporation, as defined in paragraph (g)(2)(ii) of this subsection. For example, a sole proprietor, a partner in a partnership, or a director solely serving on a corporation's board of directors (and not otherwise providing services to the corporation as an employee) is not an employee for purposes of section 125, and thus is not permitted to participate in a cafeteria plan. However, a sole proprietor may sponsor a cafeteria plan covering the sole proprietor's employees (but not the sole proprietor). Similarly, a partnership or S corporation may sponsor a cafeteria plan covering employees (but not a partner or 2-percent shareholder of an S corporation).

(ii) *Two percent shareholder of an S corporation.* A 2-percent shareholder of an S corporation has the meaning set forth in section 1372(b).

(iii) *Certain dual status individuals.* If an individual is an employee of an employer and also provides services to that employer as an independent contractor or director (for example, an individual is both a director and an employee of a C corp), the individual is eligible to participate in that employer's cafeteria plan solely in his or her capacity as an employee. This rule does not apply to partners or to 2-percent shareholders of an S corporation.

(iv) *Examples.* The following examples illustrate the rules in paragraphs (g)(2)(ii) and (g)(2)(iii) of this section:

Example 1. Two-percent shareholders of an S corporation. (i) Employer K, an S corporation, maintains a cafeteria plan for its employees (other than 2-percent shareholders of an S corporation). Employer K's taxable year and the plan year are the calendar year. On January 1, 2009, individual Z owns 5 percent of the outstanding stock in Employer K. Y, who owns no stock in Employer K, is married to Z. Y and Z are employees of Employer K. Z is a 2-percent shareholder in Employer K (as defined in section 1372(b)). Y is also a 2-percent shareholder in Employer K by operation of the attribution rules in section 318(a)(1)(A)(i).

(ii) On July 15, 2009, Z sells all his stock in Employer K to an unrelated third party, and ceases to be a 2-percent shareholder. Y and Z continue to work as employees of Employer K during the entire 2009 calendar year. Y and Z are ineligible to participate in Employer K's cafeteria plan for the 2009 plan year.

Example 2. Director and employee. T is an employee and also a director of Employer L, a C corp that sponsors a cafeteria plan. The cafeteria plan allows only employees of Employer L to participate in the cafeteria plan. T's annual compensation as an employee is $50,000; T is also paid $3,000 annually in director's fees. T makes a timely election to salary reduce $5,000 from his employee compensation for dependent care benefits. T makes no election with respect to his compensation as a director. T may participate in the cafeteria plan in his capacity as an employee of Employer L.

(3) *Limits on participation by former employees.* Although former employees are treated as employees, a cafeteria plan may not be established or maintained predominantly for the benefit of former employees of the employer. Such a plan is not a cafeteria plan.

(4) *No participation by the spouse or dependent of an employee.* (i) *Benefits allowed to participant's spouse or dependents but not participation.* The spouse or dependents of employees may not be participants in a cafeteria plan unless they are also employees. However, a cafeteria plan may provide benefits to spouses and dependents of participants. For example, although an employee's spouse may benefit from the employee's election of accident and health insurance coverage or of coverage through a dependent care assistance program, the spouse may not participate in a cafeteria plan (that is, the spouse may not be given the opportunity to elect or purchase benefits offered by the plan).

(ii) *Certain elections after employee's death.* An employee's spouse is not a participant in a cafeteria plan merely because the spouse has the right, upon the death of the employee, to elect among various settlement options or to elect among permissible distribution options with respect to the deceased employee's benefits through a section 401(k) plan, Health Savings Account, or certain group-term life insurance offered through the cafeteria plan. See §54.4980B–2, Q & A 8 and §54.4980B–4, Q & A–1 of this chapter on COBRA rights of a participant's spouse or dependents.

(5) *Employees of certain controlled groups.* All employees who are treated as employed by a single employer under section 414(b), (c), (m), or (o) are treated as employed by a single employer for purposes of section 125. Section 125(g)(4); section 414(t).

(h) *After-tax employee contributions*—(1) *Certain after-tax employee contributions treated as cash.* In addition to the cash benefits described in paragraph (a)(2) of this section, in general, a benefit is treated as cash for purposes of section 125 if the benefit does not defer compensation (except as provided in paragraph (o) of this section) and an employee who receives the benefit purchases such benefit with after-tax employee contributions or is treated, for all purposes under the Code (including, for example, reporting and withholding purposes), as receiving, at the time that the benefit is received, cash compensation equal to the full value of the benefit at that time and then purchasing the benefit with after-tax employee contributions. Thus, for example, long-term disability coverage is treated as cash for purposes of section 125 if the cafeteria plan provides that an employee may purchase the coverage through the cafeteria plan with after-tax employee contributions or provides that the employee receiving such coverage is treated as having received cash compensation equal to the value of the coverage and then as having purchased the coverage with after-tax employee contributions. Also, for example, a cafeteria plan may offer employees the opportunity to purchase, with after-tax employee contributions, group-term life insurance on the life of an employee (providing no permanent benefits), an accident and health plan, or a dependent care assistance program.

(2) *Accident and health coverage purchased for someone other than the employee's spouse or dependents with after-tax employee contributions.* If the requirements of section 106 are satisfied, employer-provided accident and health coverage for an employee and his or her spouse or dependents is excludible from

the employee's gross income. The fair market value of coverage for any other individual, provided with respect to the employee, is includible in the employee's gross income. §1.106–1; §1.61–21(a)(4), and §1.61–21(b)(1). A cafeteria plan is permitted to allow employees to elect accident and health coverage for an individual who is not the spouse or dependent of the employee as a taxable benefit.

(3) *Example.* The following example illustrates the rules of this paragraph (h):

Example. Accident and health plan coverage for individuals who are not a spouse or dependent of an employee. (i) Employee C participates in Employer M's cafeteria plan. Employee C timely elects salary reduction for employer-provided accident and health coverage for himself and for accident and health coverage for his former spouse. C's former spouse is not C's dependent. A former spouse is not a spouse as defined in section 152.

(ii) The fair market value of the coverage for the former spouse is $1,000. Employee C has $1,000 includible in gross income for the accident and health coverage of his former spouse, because the section 106 exclusion applies only to employer-provided accident and health coverage for the employee or the employee's spouse or dependents.

(iii) No payments or reimbursements received under the accident and health coverage result in gross income to Employee C or to the former spouse. The result is the same if the $1,000 for coverage of C's former spouse is paid from C's after-tax income outside the cafeteria plan.

(i) *Prohibited taxable benefits.* Any taxable benefit not described in paragraph (a)(2) of this section and not treated as cash for purposes of section 125 in paragraph (h) of this section is not permitted to be included in a cafeteria plan. A plan that offers taxable benefits other than the taxable benefits described in paragraph (a)(2) and (h) of this section is not a cafeteria plan.

(j) *Coordination with other rules*—(1) *In general.* If a benefit is excludible from an employee's gross income when provided separately, the benefit is excludible from gross income when provided through a cafeteria plan. Thus, a qualified benefit is excludible from gross income if both the rules under section 125 and the specific rules providing for the exclusion of the benefit from gross income are satisfied. For example, if the nondiscrimination rules for specific qualified benefits (for example, sections 79(d), 105(h), 129(d)(2), 137(c)(2)) are not satisfied, those qualified benefits are includible in gross income. Thus, if $50,000 in group-term life insurance is offered through a cafeteria plan, the nondiscrimination rules in section 79(d) must be satisfied in order to exclude the coverage from gross income.

(2) *Section 125 nondiscrimination rules.* Qualified benefits are includible in the gross income of highly compensated participants or key employees if the nondiscrimination rules of section 125 are not satisfied. See §1.125–7.

(3) *Taxable benefits.* If a benefit that is includible in gross income when offered separately is offered through a cafeteria plan, the benefit continues to be includible in gross income.

(k) *Group-term life insurance*—(1) *In general.* In addition to offering up to $50,000 in group-term life insurance coverage excludible under section 79(a), a cafeteria plan may offer coverage in excess of that amount. The cost of coverage in excess of $50,000 in group-term life insurance coverage provided under a policy or policies carried directly or indirectly by one or more employers (taking into account all coverage provided both through a cafeteria plan and outside a cafeteria plan) is includible in an employee's gross income. Group-term life insurance combined with permanent benefits, within the meaning of §1.79–0, is a prohibited benefit in a cafeteria plan.

(2) *Determining cost of insurance includible in employee's gross income.* (i) *In general.* If the aggregate group-term life insurance coverage on the life of the employee (under policies carried directly or indirectly by the employer) exceeds $50,000, all or a portion of the insurance is provided through a cafeteria plan, and the group-term life insurance is provided through a plan that meets the nondiscrimination rules of section 79(d), the amount includible in an employee's gross income is determined under paragraphs (k)(2)(i)(A) through (C) of this section. For each employee—

(A) The entire amount of salary reduction and employer flex-credits through a cafeteria plan for group-term life insurance coverage on the life of the employee is excludible from the employee's gross income, regardless of the amount of employer-provided group-term life insurance on the employee's life (that is, whether or not the coverage provided to the employee both through the cafeteria plan and outside the cafeteria plan exceeds $50,000);

(B) The cost of the group-term life insurance in excess of $50,000 of coverage is includible in the employee's gross income. The amount includible in the employee's income is determined using the rules of §1.79–3 and Table I (*Uniform Premiums for $1,000 of Group-Term Life Insurance Protection*). See subparagraph (C) of this paragraph (k)(2)(i) for determining the amount paid by the employee for purposes of reducing the Table I amount includible in income under §1.79–3.

(C) In determining the amount paid by the employee toward the purchase of the group-term life insurance for purposes of §1.79–3, only an employee's after-tax contributions are treated as an amount paid by the employee.

(ii) *Examples.* The rules in this paragraph (k) are illustrated by the following examples, in which the group-term life insurance coverage satisfies the nondiscrimination rules in section 79(d), provides no permanent benefits, is for a 12-month period, is the only group-term life insurance coverage provided under a policy carried directly or indirectly by the employer, and applies Table I (*Uniform Premiums for $1,000 of Group-Term Life Insurance Protection) effective July 1, 1999:*

Example 1. Excess group-term life insurance coverage provided through salary reduction in a cafeteria plan. (i) Employer N provides group-term life insurance coverage to its employees only through its cafeteria plan. Employer N's cafeteria plan allows employees to elect salary reduction for group-term life insurance. Employee B, age 42, elected salary reduction of $200 for $150,000 of group-term life insurance. None of the group-term life insurance is paid through after-tax employee contributions.

(ii) B's $200 of salary reduction for group-term life insurance is excludible from B's gross income under paragraph (k)(2)(i)(A).

(iii) B has a total of $150,000 of group-term life insurance. The group-term life insurance in excess of the dollar limitation of section 79 is $100,000 (150,000 - 50,000).

(iv) The Table I cost is $120 for $100,000 of group-term life insurance for an individual between ages 40 to 44. The Table I cost of $120 is reduced by zero (because B paid no portion of the group-term life insurance with after-tax employee contributions), under paragraphs (k)(2)(i)(A)-(B) of this section.

(v) The amount includible in B's gross income for the $100,000 of excess group-term life insurance is $120.

Example 2. Excess group-term life insurance coverage provided through salary reduction in a cafeteria plan where employee purchases a portion of group-term life insurance coverage with after-tax contributions. (i) Same facts as *Example 1*, except that B elected salary reduction of $100 and makes an after-tax contribution of $100 toward the purchase of group-term life insurance coverage.

(ii) B's $100 of salary reduction for group-term life insurance is excludible from B's gross income, under paragraph (k)(2)(i)(A) of this section.

(iii) B has a total of $150,000 of group-term life insurance. The group-term life insurance in excess of the dollar limitation of section 79 is $100,000 (150,000 - 50,000).

(iv) The Table I cost is $120 for $100,000 of group-term life insurance for an individual between ages 40 to 44, under paragraph (k)(2)(i)(B). The Table I cost of $120 is reduced by $100 (because B paid $100 for the group-term life insurance with after-tax employee contributions), under paragraphs (k)(2)(i)(B) and (k)(2)(i)(C) of this section.

(v) The amount includible in B's gross income for the $100,000 of excess group-term life insurance coverage is $20.

Example 3. Excess group-term life insurance coverage provided through salary reduction in a cafeteria plan and outside a cafeteria plan. (i) Same facts as *Example 1* except that Employer N also provides (at no cost to employees) group-term life insurance coverage equal to each employee's annual salary. Employee B's annual salary is $150,000. B has $150,000 of group-term life insurance directly from Employer N, and also $150,000 coverage through Employer N's cafeteria plan.

(ii) B's $200 of salary reduction for group-term life insurance is excludible from B's gross income, under paragraph (k)(2)(i)(A) of this section.

(iii) B has a total of $300,000 of group-term life insurance. The group-term life insurance in excess of the dollar limitation of section 79 is $250,000 (300,000 - 50,000).

(iv) The Table I cost is $300 for $250,000 of group-term life insurance for an individual between ages 40 to 44. The Table I cost of $300 is reduced by zero (because B paid no portion of the group-term life insurance with after-tax employee contributions), under paragraphs (k)(2)(i)(B) and (k)(2)(i)(C) of this section.

(v) The amount includible in B's gross income for the $250,000 of excess group-term life insurance is $300.

Example 4. Excess group-term life insurance coverage provided through salary reduction in a cafeteria plan and outside a cafeteria plan. (i) Same facts as *Example 3* except that Employee C's annual salary is $30,000. C has $30,000 of group-term life insurance coverage provided directly from Employer N, and elects an additional $30,000 of coverage for $40 through Employer N's cafeteria plan. C is 42 years old.

(ii) C's $40 of salary reduction for group-term life insurance is excludible from C's gross income, under paragraph (k)(2)(i)(A) of this section.

(iii) C has a total of $60,000 of group-term life insurance. The group-term life insurance in excess of the dollar limitation of section 79 is $10,000 (60,000 - 50,000).

(iv) The Table I cost is $12 for $10,000 of group-term life insurance for an individual between ages 40 to 44. The Table I cost of $12 is reduced by zero (because C paid no portion of the group-term life insurance with after-tax employee contributions), under paragraphs (k)(2)(i)(B) and (k)(2)(i)(C) of this section.

(v) The amount includible in C's gross income for the $10,000 of excess group-term life insurance coverage is $12.

(l) *COBRA premiums*—(1) *Paying COBRA premiums through a cafeteria plan.* Under §1.125–4(c)(3)(iv), COBRA premiums for an employer-provided group health plan are qualified benefits if:

(i) The premiums are excludible from an employee's income under section 106; or

(ii) The premiums are for the accident and health plan of the employer sponsoring the cafeteria plan, even if the fair market value of the premiums is includible in an employee's gross income. See also paragraph (e)(2) in §1.125–5 and §54.4980B–2, Q & A–8 of this chapter for COBRA rules for health FSAs.

(2) *Example.* The following example illustrates the rules of this paragraph (l):

Example. COBRA premiums. (i) Employer O maintains a cafeteria plan for full-time employees, offering an election between cash and employer-provided accident and health insurance and other qualified benefits. Employees A, B, and C participate in the cafeteria plan. On July 1, 2009, Employee A has a qualifying event (as defined in §54.4980B–4 of this chapter).

(ii) Employee A was a full-time employee and became a part-time employee and for that reason, is no longer covered by Employer O's accident and health plan. Under §1.125–4(f)(3)(ii), Employee A changes her election to salary reduce to pay her COBRA premiums.

(iii) Employee B previously worked for another employer, quit and elected COBRA. Employee B begins work for Employer O on July 1, 2009, and becomes eligible to participate in Employer O's cafeteria plan on July 1, 2009, but will not be eligible to participate in Employer O's accident and health plan until October 1, 2009. Employee B elects to salary reduce to pay COBRA premiums for coverage under the accident and health plan sponsored by B's former employer.

(iv) Employee C and C's spouse are covered by Employer O's accident and health plan until July 1, 2009, when C's divorce from her spouse became final. C continues to be covered by the accident and health plan. On July 1, 2009, C requests to pay COBRA premiums for her former spouse (who is not C's dependent (as defined in section 152)) with after-tax employee contributions.

(v) Salary reduction elections for COBRA premiums for Employees A and B are qualified benefits for purposes of section 125 and are excludible from the gross income of Employees A and B. Employer O allows A and B to salary reduce for these COBRA premiums.

(vi) Employer O allows C to pay for COBRA premiums for C's former spouse, with after-tax employee contributions because although accident and health coverage for C's former spouse is permitted in a cafeteria plan, the premiums are includible in C's gross income.

(vii) The operation of Employer O's cafeteria plan satisfies the requirements of this paragraph (l).

(m) *Payment or reimbursement of employees' individual accident and health insurance premiums*—(1) *In general.* The payment or reimbursement of employees' substantiated individual health insurance premiums is excludible from employees' gross income under section 106 and is a qualified benefit for purposes of section 125.

(2) *Example.* The following example illustrates the rule of this paragraph (m):

Example. Payment or reimbursement of premiums. (i) Employer P's cafeteria plan offers the following benefits for employees who are covered by an individual health insurance policy. The employee substantiates the expenses for the premiums for the policy (as required in paragraph (b)(2) in §1.125–6) before any payments or reimbursements to the employee for premiums are made. The payments or reimbursements are made in the following ways:

(ii) The cafeteria plan reimburses each employee directly for the amount of the employee's substantiated health insurance premium;

(iii) The cafeteria plan issues the employee a check payable to the health insurance company for the amount of the employee's health insurance premium, which the employee is obligated to tender to the insurance company;

(iv) The cafeteria plan issues a check in the same manner as (iii), except that the check is payable jointly to the employee and the insurance company; or

(v) Under these circumstances, the individual health insurance policies are accident and health plans as defined in §1.106–1. This benefit is a qualified benefit under section 125.

(n) *Section 105 rules for accident and health plan offered through a cafeteria plan*—(1) *General rule.* In order for an accident and health plan to be a qualified benefit that is excludible from gross income if elected through a cafeteria plan, the cafeteria plan must satisfy section 125 and the accident and health plan must satisfy section 105(b) and (h).

(2) *Section 105(b) requirements in general.* Section 105(b) provides an exclusion from gross income for amounts paid to an employee from an employer-funded accident and health plan specifically to reimburse the employee for certain expenses for medical care (as defined in section 213(d)) incurred by the employee or the employee's spouse or dependents during the period for which the benefit is provided to the employee (that is, when the employee is covered by the accident and health plan).

(o) *Prohibition against deferred compensation*—(1) *In general.* Any plan that

offers a benefit that defers compensation (except as provided in this paragraph (o)) is not a cafeteria plan. See section 125(d)(2)(A). A plan that permits employees to carry over unused elective contributions, after-tax contributions, or plan benefits from one plan year to another (except as provided in paragraphs (e), (o)(3) and (4) and (p) of this section) defers compensation. This is the case regardless of how the contributions or benefits are used by the employee in the subsequent plan year (for example, whether they are automatically or electively converted into another taxable or nontaxable benefit in the subsequent plan year or used to provide additional benefits of the same type). Similarly, a cafeteria plan also defers compensation if the plan permits employees to use contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year (for example, life, health or disability if these benefits have a savings or investment feature, such as whole life insurance). See also Q & A–5 in §1.125–3, prohibiting deferring compensation from one cafeteria plan year to a subsequent cafeteria plan year. See paragraph (e) of this section for grace period rules. A plan does not defer compensation merely because it allocates experience gains (or forfeitures) among participants in compliance with paragraph (o) in §1.125–5.

(2) *Effect if a plan includes a benefit that defers the receipt of compensation or a plan operates to defer compensation.* If a plan violates paragraph (o)(1) of this section, the availability of an election between taxable and nontaxable benefits under such a plan results in gross income to the employees.

(3) *Cash or deferred arrangements that may be offered in a cafeteria plan.* (i) *In general.* A cafeteria plan may offer the benefits set forth in this paragraph (o)(3), even though these benefits defer compensation.

(ii) *Elective contributions to a section 401(k) plan.* A cafeteria plan may permit a covered employee to elect to have the employer, on behalf of the employee, pay amounts as contributions to a trust that is part of a profit-sharing or stock bonus plan or rural cooperative plan (within the meaning of section 401(k)(7)), which includes a qualified cash or deferred arrangement (as defined in section 401(k)(2)). In addition, after-tax employee contributions under a qualified plan subject to section 401(m) are permitted through a cafeteria plan. The right to make such contributions does not cause a plan to fail to be a cafeteria plan merely because, under the qualified plan, employer matching contributions (as defined in section 401(m)(4)(A)) are made with respect to elective or after-tax employee contributions.

(iii) *Additional permitted deferred compensation arrangements.* A plan maintained by an educational organization described in section 170(b)(1)(A)(ii) to the extent of amounts which a covered employee may elect to have the employer pay as contributions for post-retirement group life insurance is permitted through a cafeteria plan, if—

(A) All contributions for such insurance must be made before retirement; and

(B) Such life insurance does not have a cash surrender value at any time.

(iv) *Contributions to HSAs.* Contributions to covered employees' HSAs as defined in section 223 (but not contributions to Archer MSAs).

(4) *Paid time off.* (i) *In general.* A cafeteria plan is permitted to include elective paid time off (that is, vacation days, sick days or personal days) as a permitted taxable benefit through the plan by permitting employees to receive more paid time off than the employer otherwise provides to the employees on a nonelective basis, but only if the inclusion of elective paid time off through the plan does not operate to permit the deferral of compensation. In addition, a plan that only offers the choice of cash or paid time off is not a cafeteria plan and is not subject to the rules of section 125. In order to avoid deferral of compensation, the cafeteria plan must preclude any employee from using the paid time off or receiving cash, in a subsequent plan year, for any portion of such paid time off remaining unused as of the end of the plan year. (See paragraph (o)(4)(iii) of this section for the deadline to cash out unused elective paid time off.) For example, a plan that offers employees the opportunity to purchase paid time off (or to receive cash or other benefits through the plan in lieu of paid time off) is not a cafeteria plan if employees who purchase the paid time off for a plan year are allowed to use any unused paid time off in a subsequent plan year. This is the case even though the plan does not permit the employee to convert, in any subsequent plan year, the unused paid time off into any other benefit.

(ii) *Ordering of elective and nonelective paid time off.* In determining whether a plan providing paid time off operates to permit the deferral of compensation, a cafeteria plan must provide that employees are deemed to use paid time off in the following order:

(A) *Nonelective paid time off.* Nonelective paid time off (that is, paid time off with respect to which the employee has no election) is used first;

(B) *Elective paid time off.* Elective paid time off is used after all nonelective paid time off is used.

(iii) *Cashing out or forfeiture of unused elective paid time off, in general.* The cafeteria plan must provide that all unused elective paid time off (determined as of the last day of the plan year) must either be paid in cash (within the time specified in this paragraph (o)(4)) or be forfeited. This provision must apply uniformly to all participants in the cafeteria plan.

(A) *Cash out of unused elective paid time off.* A plan does not operate to permit the deferral of compensation merely because the plan provides that an employee who has not used all elective paid time off for a plan year receives in cash the value of such unused paid time off. The employee must receive the cash on or before the last day of the cafeteria plan's plan year to which the elective contributions used to purchase the unused elective paid time off relate.

(B) *Forfeiture of unused elective paid time off.* If the cafeteria plan provides for forfeiture of unused elective paid time off, the forfeiture must be effective on the last day of the plan year to which the elective contributions relate.

(iv) *No grace period for paid time off.* The grace period described in paragraph (e) of this section does not apply to paid time off.

(v) *Examples.* The following examples illustrate the rules of this paragraph (o)(4):

Example 1. Plan cashes out unused elective paid time off on or before the last day of the plan year. (i) Employer Q provides employees with two weeks of paid time off for each calendar year. Employer Q's human resources policy (that is, outside the cafeteria plan), permits employees to carry over one nonelective week of paid time off to the next year. Employer Q maintains a calendar year cafeteria plan that per-

mits the employee to purchase, with elective contributions, an additional week of paid time off.

(ii) For the 2009 plan year, Employee A (with a calendar tax year), timely elects to purchase one additional week of paid time off. During 2009, Employee A uses only two weeks of paid time off. Employee A is deemed to have used two weeks of nonelective paid time off and zero weeks of elective paid time off.

(iii) Pursuant to the cafeteria plan, the plan pays Employee A the value of the unused elective paid time off week in cash on December 31, 2009. Employer Q includes this amount on the 2009 Form W–2 for Employee A. This amount is included in Employee A's gross income in 2009. The cafeteria plan's terms and operations do not violate the prohibition against deferring compensation.

Example 2. Unused nonelective paid time off carried over to next plan year. (i) Same facts as *Example 1*, except that Employee A uses only one week of paid time off during the year. Pursuant to the cafeteria plan, Employee A is deemed to have used one nonelective week, and having retained one nonelective week and one elective week of paid time off. Employee A receives in cash the value of the unused elective paid time off on December 31, 2009. Employer Q includes this amount on the 2009 Form W–2 for Employee A. Employee A must report this amount as gross income in 2009.

(ii) Pursuant to Employer Q's human resources policy, Employee A is permitted to carry over the one nonelective week of paid time off to the next year. Nonelective paid time off is not part of the cafeteria plan (that is, neither Employer Q nor the cafeteria plan permit employees to exchange nonelective paid time off for other benefits).

(iii) The cafeteria plan's terms and operations do not violate the prohibition against deferring compensation.

Example 3. Forfeiture of unused elective paid time off. Same facts as *Example 2*, except that pursuant to the cafeteria plan, Employee A forfeits the remaining one week of elective paid time off. The cafeteria plan's terms and operations do not violate the prohibition against deferring compensation.

Example 4. Unused elective paid time off carried over to next plan year. Same facts as *Example 1*, except that Employee A uses only two weeks of paid time off during the 2009 plan year, and, under the terms of the cafeteria plan, Employee A is treated as having used the two nonelective weeks and as having retained the one elective week. The one remaining week (that is, the elective week) is carried over to the next plan year (or the value thereof used for any other purpose in the next plan year). The plan operates to permit deferring compensation and is not a cafeteria plan.

Example 5. Paid time off exchanged for accident and health insurance premiums. Employer R provides employees with four weeks of paid time off for a year. Employer R's calendar year cafeteria plan permits employees to exchange up to one week of paid time off to pay the employee's share of accident and health insurance premiums. For the 2009 plan year, Employee B (with a calendar tax year), timely elects to exchange one week of paid time off (valued at $769) to pay accident and health insurance premiums for 2009. The $769 is excludible from Employee B's gross income under section 106. The cafeteria plan's terms and operations do not violate the prohibition against deferring compensation.

(p) *Benefits relating to more than one year*—(1) *Benefits in an accident and health insurance policy relating to more than one year.* Consistent with section 125(d), an accident and health insurance policy may include certain benefits, as set forth in this paragraph (p)(1), without violating the prohibition against deferred compensation.

(i) *Permitted benefits.* The following features or benefits of insurance policies do not defer compensation—

(A) Credit toward the deductible for unreimbursed covered expenses incurred in prior periods;

(B) Reasonable lifetime maximum limit on benefits;

(C) Level premiums;

(D) Premium waiver during disability;

(E) Guaranteed policy renewability of coverage, without further evidence of insurability (but not guaranty of the amount of premium upon renewal);

(F) Coverage for a specified accidental injury;

(G) Coverage for a specified disease or illness, including payments at initial diagnosis of the specified disease or illness, and progressive payments of a set amount per month following the initial diagnosis (sometimes referred to as progressive diagnosis payments); and

(H) Payment of a fixed amount per day (or other period) of hospitalization.

(ii) *Requirements of permitted benefits.* All benefits described in paragraph (p)(1)(i) of this section must in addition satisfy all of the following requirements—

(A) No part of any benefit is used in one plan year to purchase a benefit in a subsequent plan year;

(B) The policies remain in force only so long as premiums are timely paid on a current basis, and, irrespective of the amount of premiums paid in prior plan years, if the current premiums are not paid, all coverage for new diseases or illnesses lapses. See paragraph (p)(1)(i)(D), allowing premium waiver during disability;

(C) There is no investment fund or cash value to rely upon for payment of premiums; and

(D) No part of any premium is held in a separate account for any participant or beneficiary, or otherwise segregated from the assets of the insurance company.

(2) *Benefits under a long-term disability policy relating to more than one year.* A long-term disability policy paying disability benefits over more than one year does not violate the prohibition against deferring compensation.

(3) *Reasonable premium rebates or policy dividends.* Reasonable premium rebates or policy dividends paid with respect to benefits provided through a cafeteria plan do not constitute impermissible deferred compensation if such rebates or dividends are paid before the close of the 12-month period immediately following the cafeteria plan year to which such rebates and dividends relate.

(4) *Mandatory two-year election for vision or dental insurance.* When a cafeteria plan offers vision or dental insurance that requires a mandatory two-year coverage period, but not longer (sometimes referred to as a "two-year lock-in"), the mandatory two-year coverage period does not result in deferred compensation in violation of section 125(d)(2), provided both of the following requirements are satisfied—

(i) The premiums for each plan year are paid no less frequently than annually; and

(ii) In no event does a cafeteria plan use salary reduction or flex-credits relating to the first year of a two-year election to apply to vision or dental insurance for the second year of the two-year election.

(5) *Using salary reduction amounts from one plan year to pay accident and health insurance premiums for the first month of the immediately following plan year.*

(i) *In general.* Salary reduction amounts from the last month of one plan year of a cafeteria plan may be applied to pay accident and health insurance premiums for insurance during the first month of the immediately following plan year, if done on a uniform and consistent basis with respect to all participants (based on the usual payroll interval for each group of participants).

(ii) *Example.* The following example illustrates the rules in this paragraph (p)(5):

Example. Salary reduction payments in December of calendar plan year to pay accident and health insurance premiums for January. Employer S maintains a calendar year cafeteria plan. The cafeteria plan offers employees a salary reduction election for accident and health insurance. The plan provides that employees' salary reduction amounts for the last pay period in December are applied to pay accident and health insurance premiums for the immediately fol-

lowing January. All employees are paid bi-weekly. For the plan year ending December 31, 2009, Employee C elects salary reduction of $3,250 for accident and health coverage. For the last pay period in December 2009, $125 (3,250/26) is applied to the accident and health insurance premium for January 2010. This plan provision does not violate the prohibition against deferring compensation.

(q) *Nonqualified benefits*—(1) *In general.* The following benefits are nonqualified benefits that are not permitted to be offered in a cafeteria plan—

(i) Scholarships described in section 117;

(ii) Employer-provided meals and lodging described in section 119;

(iii) Educational assistance described in section 127;

(iv) Fringe benefits described in section 132;

(v) Long-term care insurance, or any product which is advertised, marketed or offered as long-term care insurance;

(vi) Long-term care services (but see paragraph (q)(3) of this section);

(vii) Group-term life insurance on the life of any individual other than an employee (whether includible or excludible from the employee's gross income);

(viii) Health reimbursement arrangements (HRAs) that provide reimbursements up to a maximum dollar amount for a coverage period and that all or any unused amount at the end of a coverage period is carried forward to increase the maximum reimbursement amount in subsequent coverage periods;

(ix) Contributions to Archer MSAs (section 220); and

(x) Elective deferrals to a section 403(b) plan.

(2) *Nonqualified benefits not permitted in a cafeteria plan.* The benefits described in this paragraph (q) are not qualified benefits or taxable benefits or cash for purposes of section 125 and thus may not be offered in a cafeteria plan regardless of whether any such benefit is purchased with after-tax employee contributions or on any other basis. A plan that offers a nonqualified benefit is not a cafeteria plan. Employees' elections between taxable and nontaxable benefits through such plan result in gross income to the participants for any benefit elected. See section 125(f). See paragraph (q)(3) of this section for special rule on long-term care insurance purchased through an HSA.

(3) *Long-term care insurance or services purchased through an HSA.* Although long-term care insurance is not a qualified benefit and may not be offered in a cafeteria plan, a cafeteria plan is permitted to offer an HSA as a qualified benefit, and funds from the HSA may be used to pay eligible long-term care premiums on a qualified long-term care insurance contract or for qualified long-term care services.

(r) *Employer contributions to a cafeteria plan*—(1) *Salary reduction-in general.* The term *employer contributions* means amounts that are not currently available (after taking section 125 into account) to the employee but are specified in the cafeteria plan as amounts that an employee may use for the purpose of electing benefits through the plan. A plan may provide that employer contributions may be made, in whole or in part, pursuant to employees' elections to reduce their compensation or to forgo increases in compensation and to have such amounts contributed, as employer contributions, by the employer on their behalf. See also §1.125–5 (flexible spending arrangements). Also, a cafeteria plan is permitted to require employees to elect to pay the employees' share of any qualified benefit through salary reduction and not with after-tax employee contributions. A cafeteria plan is also permitted to pay reasonable cafeteria plan administrative fees through salary reduction amounts, and these salary reduction amounts are excludible from an employee's gross income.

(2) *Salary reduction as employer contribution.* Salary reduction contributions are employer contributions. An employee's salary reduction election is an election to receive a contribution by the employer in lieu of salary or other compensation that is not currently available to the employee as of the effective date of the election and that does not subsequently become currently available to the employee.

(3) *Employer flex-credits.* A cafeteria plan may also provide that the employer contributions will or may be made on behalf of employees equal to (or up to) specified amounts (or specified percentages of compensation) and that such nonelective contributions are available to employees for the election of benefits through the plan.

(4) *Elective contributions to a section 401(k) plan.* See §1.401(k)–1 for general rules relating to contributions to section 401(k) plans.

(s) *Effective/applicability date.* It is proposed that these regulations apply on and after plan years beginning on or after January 1, 2009, except that the rule in paragraph (k)(2)(i)(B) of this section is effective as of the date the proposed regulations are published in the **Federal Register**.

§1.125–2 Cafeteria plans; elections.

(a) *Rules relating to making and revoking elections*—(1) *Elections in general.* A plan is not a cafeteria plan unless the plan provides in writing that employees are permitted to make elections among the permitted taxable benefits and qualified benefits offered through the plan for the plan year (and grace period, if applicable). All elections must be irrevocable by the date described in paragraph (a)(2) of this section except as provided in paragraph (a)(4) of this section. An election is not irrevocable if, after the earlier of the dates specified in paragraph (a)(2) of this section, employees have the right to revoke their elections of qualified benefits and instead receive the taxable benefits for such period, without regard to whether the employees actually revoke their elections.

(2) *Timing of elections.* In order for employees to exclude qualified benefits from employees' gross income, benefit elections in a cafeteria plan must be made before the earlier of—

(i) The date when taxable benefits are currently available; or

(ii) The first day of the plan year (or other coverage period).

(3) *Benefit currently available to an employee-in general.* Cash or another taxable benefit is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable benefit at the employee's discretion. However, cash or another taxable benefit is not currently available to an employee if there is a significant limitation or restriction on the employee's right to receive the benefit currently. Similarly, a benefit is not currently available as of a date if the employee may under no circumstances receive the benefit before a particular time in the future. The

determination of whether a benefit is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451.

(4) *Exceptions to rule on making and revoking elections.* If a cafeteria plan incorporates the change in status rules in §1.125–4, to the extent provided in those rules, an employee who experiences a change in status (as defined in §1.125–4) is permitted to revoke an existing election and to make a new election with respect to the remaining portion of the period of coverage, but only with respect to cash or other taxable benefits that are not yet currently available. See paragraph (c)(1) of this section for a special rule for changing elections prospectively for HSA contributions and paragraph (r)(4) in §1.125–1 for section 401(k) elections. Also, only an employee of the employer sponsoring a cafeteria plan is allowed to make, revoke or change elections in the employer's cafeteria plan. The employee's spouse, dependent or any other individual other than the employee may not make, revoke or change elections under the plan.

(5) *Elections not required on written paper documents.* A cafeteria plan does not fail to meet the requirements of section 125 merely because it permits employees to use electronic media for such transactions. The safe harbor in §1.401(a)–21 applies to electronic elections, revocations and changes in elections under section 125.

(6) *Examples.* The following examples illustrate the rules in this paragraph (a):

Example 1. Election not revocable during plan year. Employer A's cafeteria plan offers each employee the opportunity to elect, for a plan year, between $5,000 cash for the plan year and a dependent care assistance program of up to $5,000 of dependent care expenses incurred by the employee during the plan year. The cafeteria plan requires employees to elect between these benefits before the beginning of the plan year. After the year has commenced, employees are prohibited from revoking their elections. The cafeteria plan allows revocation of elections based on changes in status (as described in §1.125–4). Employees who elected the dependent care assistance program do not include the $5,000 cash in gross income. The cafeteria plan satisfies the requirements in this paragraph (a).

Example 2. Election revocable during plan year. Same facts as *Example 1* except that Employer A's cafeteria plan allows employees to revoke their elections for dependent care assistance at any time during the plan year and receive the unused amount of dependent care assistance as cash. The cafeteria plan fails to satisfy the requirements in this paragraph (a), and is not a cafeteria plan. All employees are treated as having received the $5,000 in cash even if they do not revoke their elections. The same result occurs even though the cash is not payable until the end of the plan year.

(b) *Automatic elections*—(1) *In general.* For new employees or current employees who fail to timely elect between permitted taxable benefits and qualified benefits, a cafeteria plan is permitted, but is not required, to provide default elections for one or more qualified benefits (for example, an election made for any prior year is deemed to be continued for every succeeding plan year, unless changed).

(2) *Example.* The following example illustrates the rules in this paragraph (b):

Example. Automatic elections for accident and health insurance. (i) Employer B maintains a calendar year cafeteria plan. The cafeteria plan offers accident and health insurance with an option for employee-only or family coverage. All employees are eligible to participate in the cafeteria plan immediately upon hire.

(ii) The cafeteria plan provides for an automatic enrollment process: each new employee and each current employee is automatically enrolled in employee-only coverage under the accident and health insurance plan, and the employee's salary is reduced to pay the employee's share of the accident and health insurance premium, unless the employee affirmatively elects cash. Alternatively, if the employee has a spouse or child, the employee can elect family coverage.

(iii) When an employee is hired, the employee receives a notice explaining the automatic enrollment process and the employee's right to decline coverage and have no salary reduction. The notice includes the salary reduction amounts for employee-only coverage and family coverage, procedures for exercising the right to decline coverage, information on the time by which an election must be made, and the period for which an election is effective. The notice is also given to each current employee before the beginning of each subsequent plan year, except that the notice for a current employee includes a description of the employee's existing coverage, if any.

(iv) For a new employee, an election to receive cash or to have family coverage rather than employee-only coverage is effective if made when the employee is hired. For a current employee, an election is effective if made prior to the start of each calendar year or under any other circumstances permitted under §1.125–4. An election made for any prior year is deemed to be continued for every succeeding plan year, unless changed.

(v) Contributions used to purchase accident and health insurance through a cafeteria plan are not includible in the gross income of the employee solely because the plan provides for automatic enrollment as a default election whereby the employee's salary is reduced each year to pay for a portion of the accident and health insurance through the plan (unless the employee affirmatively elects cash).

(c) *Election rules for salary reduction contributions to HSAs*—(1) *Prospective elections and changes in salary reduction elections allowed.* Contributions may be made to an HSA through a cafeteria plan. A cafeteria plan offering HSA contributions through salary reduction may permit employees to make prospective salary reduction elections or change or revoke salary reduction elections for HSA contributions (for example, to increase or decrease salary reduction elections for HSA contributions) at any time during the plan year, effective before salary becomes currently available. If a cafeteria plan offers HSA contributions as a qualified benefit, the plan must—

(i) Specifically describe the HSA contribution benefit;

(ii) Allow a participant to prospectively change his or her salary reduction election for HSA contributions on a monthly basis (or more frequently); and

(iii) Allow a participant who becomes ineligible to make HSA contributions to prospectively revoke his or her salary reduction election for HSA contributions.

(2) *Example.* The following example illustrates the rules in this paragraph (c):

Example. Prospective HSA salary reduction elections. (i) A cafeteria plan with a calendar plan year allows employees to make salary reduction elections for HSA contributions through the plan. The cafeteria plan permits employees to prospectively make, change or revoke salary contribution elections for HSA contributions, limited to one election, change or revocation per month.

(ii) Employee M participates in the cafeteria plan. Before salary becomes currently available to M, M makes the following elections. On January 2, 2009, M elects to contribute $100 for each pay period to an HSA, effective January 3, 2009. On March 15, 2009, M elects to reduce the HSA contribution to $35 per pay period, effective April 1, 2009. On May 1, 2009, M elects to discontinue all HSA contributions, effective May 15, 2009. The cafeteria plan implements all of Employee M's elections,

(iii) The cafeteria plan's operation is consistent with the section 125 election, change and revocation rules for HSA contributions.

(d) *Optional election for new employees.* A cafeteria plan may provide new employees 30 days after their hire date to make elections between cash and qualified benefits. The election is effective as of the employee's hire date. However, salary reduction amounts used to pay for such an election must be from compensation not yet currently available on the date of the election. The written cafeteria plan must provide that any employee who terminates employment and is rehired within 30 days after terminating employment (or who returns to employment following an unpaid

leave of absence of less than 30 days) is not a new employee eligible for the election in this paragraph (d).

(e) *Effective/applicability date.* It is proposed that these regulations apply on and after plan years beginning on or after January 1, 2009.

Par. 3. Sections 1.125–5, 1.125–6 and 1.125–7 are added to read as follows:

§1.125–5 Flexible spending arrangements.

(a) *Definition of flexible spending arrangement*—(1) *In general.* An FSA generally is a benefit program that provides employees with coverage which reimburses specified, incurred expenses (subject to reimbursement maximums and any other reasonable conditions). An expense for qualified benefits must not be reimbursed from the FSA unless it is incurred during a period of coverage. See paragraph (e) of this section. After an expense for a qualified benefit has been incurred, the expense must first be substantiated before the expense is reimbursed. See paragraphs (a) through (f) in §1.125–6.

(2) *Maximum amount of reimbursement.* The maximum amount of reimbursement that is reasonably available to an employee for a period of coverage must not be substantially in excess of the total salary reduction and employer flex-credit for such participant's coverage. A maximum amount of reimbursement is not substantially in excess of the total salary reduction and employer flex-credit if such maximum amount is less than 500 percent of the combined salary reduction and employer flex-credit. A single FSA may provide participants with different levels of coverage and maximum amounts of reimbursement. See paragraph (r) in §1.125–1 and paragraphs (b) and (d) in this section for the definition of salary reduction, employer flex-credit, and uniform coverage rule.

(b) *Flex-credits allowed*—(1) *In general.* An FSA in a cafeteria plan must include an election between cash or taxable benefits (including salary reduction) and one or more qualified benefits, and may include, in addition, "employer flex-credits." For this purpose, flex-credits are non-elective employer contributions that the employer makes for every employee eligible to participate in the employer's cafeteria plan, to be used at the employee's election only for one or more qualified benefits (but not as cash or a taxable benefit). See §1.125–1 for definitions of qualified benefits, cash and taxable benefits.

(2) *Example.* The following example illustrates the rules in this paragraph (b):

Example. Flex-credit. Contribution to health FSA for employees electing employer-provided accident and health plan. Employer A maintains a cafeteria plan offering employees an election between cash or taxable benefits and premiums for employer-provided accident and health insurance or coverage through an HMO. The plan also provides an employer contribution of $200 to the health FSA of every employee who elects accident and health insurance or HMO coverage. In addition, these employees may elect to reduce their salary to make additional contributions to their health FSAs. The benefits offered in this cafeteria plan are consistent with the requirements of section 125 and this paragraph (b).

(c) *Use-or-lose rule*—(1) *In general.* An FSA may not defer compensation. No contribution or benefit from an FSA may be carried over to any subsequent plan year or period of coverage. See paragraph (k)(3) in this section for specific exceptions. Unused benefits or contributions remaining at the end of the plan year (or at the end of a grace period, if applicable) are forfeited.

(2) *Example.* The following example illustrates the rules in this paragraph (c):

Example. Use-or-lose rule. (i) Employer B maintains a calendar year cafeteria plan, offering an election between cash and a health FSA. The cafeteria plan has no grace period.

(ii) Employee A plans to have eye surgery in 2009. For the 2009 plan year, Employee A timely elects salary reduction of $3,000 for a health FSA. During the 2009 plan year, Employee A learns that she cannot have eye surgery performed, but incurs other section 213(d) medical expenses totaling $1,200. As of December 31, 2009, she has $1,800 of unused benefits and contributions in the health FSA. Consistent with the rules in this paragraph (c), she forfeits $1,800.

(d) *Uniform coverage rules applicable to health FSAs*—(1) *Uniform coverage throughout coverage period—in general.* The maximum amount of reimbursement from a health FSA must be available at all times during the period of coverage (properly reduced as of any particular time for prior reimbursements for the same period of coverage). Thus, the maximum amount of reimbursement at any particular time during the period of coverage cannot relate to the amount that has been contributed to the FSA at any particular time prior to the end of the plan year. Similarly, the payment schedule for the required amount for coverage under a health FSA may not be based on the rate or amount of covered claims incurred during the coverage period. Employees' salary reduction payments must not be accelerated based on employees' incurred claims and reimbursements.

(2) *Reimbursement available at all times.* Reimbursement is deemed to be available at all times if it is paid at least monthly or when the total amount of the claims to be submitted is at least a specified, reasonable minimum amount (for example, $50).

(3) *Terminated participants.* When an employee ceases to be a participant, the cafeteria plan must pay the former participant any amount the former participant previously paid for coverage or benefits to the extent the previously paid amount relates to the period from the date the employee ceases to be a participant through the end of that plan year. See paragraph (e)(2) in this section for COBRA elections for health FSAs.

(4) *Example.* The following example illustrates the rules in this paragraph (d):

Example. Uniform coverage. (i) Employer C maintains a calendar year cafeteria plan, offering an election between cash and a health FSA. The cafeteria plan prohibits accelerating employees' salary reduction payments based on employees' incurred claims and reimbursements.

(ii) For the 2009 plan year, Employee N timely elects salary reduction of $3,000 for a health FSA. Employee N pays the $3,000 salary reduction amount through salary reduction of $250 per month throughout the coverage period. Employee N is eligible to receive the maximum amount of reimbursement of $3,000 at all times throughout the coverage period (reduced by prior reimbursements).

(iii) N incurs $2,500 of section 213(d) medical expenses in January, 2009. The full $2,500 is reimbursed although Employee N has made only one salary reduction payment of $250. N incurs $500 in medical expenses in February, 2009. The remaining $500 of the $3,000 is reimbursed. After Employee N submits a claim for reimbursement and substantiates the medical expenses, the cafeteria plan reimburses N for the $2,500 and $500 medical expenses. Employer C's cafeteria plan satisfies the uniform coverage rule.

(5) *No uniform coverage rule for FSAs for dependent care assistance or adoption assistance.* The uniform coverage rule applies only to health FSAs and does not apply to FSAs for dependent care assistance or adoption assistance. See paragraphs (i) and (j) of this section for the rules for FSAs for dependent care assistance and adoption assistance.

(e) *Required period of coverage for a health FSA, dependent care FSA and adoption assistance FSA*—(1) *Twelve-month period of coverage—in general.* An FSA's period of coverage must be 12 months. However, in the case of a short plan year, the period of coverage is the entire short plan year. See paragraph (d) in §1.125–1 for rules on plan years and changing plan years.

(2) *COBRA elections for health FSAs.* For the application of the health care continuation rules of section 4980B of the Code to health FSAs, see Q & A–2 in §54.4980B–2 of this chapter.

(3) *Separate period of coverage permitted for each qualified benefit offered through FSA.* Dependent care assistance, adoption assistance, and a health FSA are each permitted to have a separate period of coverage, which may be different from the plan year of the cafeteria plan.

(f) *Coverage on a month-by-month or expense-by-expense basis prohibited.* In order for reimbursements from an accident and health plan to qualify for the section 105(b) exclusion, an employer-funded accident and health plan offered through a cafeteria plan may not operate in a manner that enables employees to purchase the accident and health plan coverage only for periods when employees expect to incur medical care expenses. Thus, for example, if a cafeteria plan permits employees to receive accident and health plan coverage on a month-by-month or an expense-by-expense basis, reimbursements from the accident and health plan fail to qualify for the section 105(b) exclusion. If, however, the period of coverage under an accident and health plan offered through a cafeteria plan is twelve months and the cafeteria plan does not permit an employee to elect specific amounts of coverage, reimbursement, or salary reduction for less than twelve months, the cafeteria plan does not operate to enable participants to purchase coverage only for periods during which medical care will be incurred. See §1.125–4 and paragraph (a) in §1.125–2 regarding the revocation of elections during a period of coverage on account of changes in family status.

(g) *FSA administrative practices*—(1) *Limiting health FSA enrollment to employees who participate in the employer's accident and health plan.* At the employer's option, a cafeteria plan is permitted to provide that only those employees who participate in one or more specified employer-provided accident and health plans may participate in a health FSA. See §1.125–7 for nondiscrimination rules.

(2) *Interval for employees' salary reduction contributions.* The cafeteria plan is permitted to specify any interval for employees' salary reduction contributions. The interval specified in the plan must be uniform for all participants.

(h) *Qualified benefits permitted to be offered through an FSA.* Dependent care assistance (section 129), adoption assistance (section 137) and a medical reimbursement arrangement (section 105(b)) are permitted to be offered through an FSA in a cafeteria plan.

(i) *Section 129 rules for dependent care assistance program offered through a cafeteria plan*—(1) *General rule.* In order for dependent care assistance to be a qualified benefit that is excludible from gross income if elected through a cafeteria plan, the cafeteria plan must satisfy section 125 and the dependent care assistance must satisfy section 129.

(2) *Dependent care assistance in general.* Section 129(a) provides an employee with an exclusion from gross income both for an employer-funded dependent care assistance program and for amounts paid or incurred by the employer for dependent care assistance provided to the employee, if the amounts are paid or incurred through a dependent care assistance program. See paragraph (a)(4) in §1.125–6 on when dependent care expenses are incurred.

(3) *Reimbursement exclusively for dependent care assistance.* A dependent care assistance program may not provide reimbursements other than for dependent care expenses; in particular, if an employee has dependent care expenses less than the amount specified by salary reduction, the plan may not provide other taxable or nontaxable benefits for any portion of the specified amount not used for the reimbursement of dependent care expenses. Thus, if an employee has elected coverage under the dependent care assistance program and the period of coverage has commenced, the employee must not have the right to receive amounts from the program other than as reimbursements for dependent care expenses. This is the case regardless of whether coverage under the program is purchased with contributions made at the employer's discretion, at the employee's discretion, or pursuant to a collective bargaining agreement. Arrangements formally outside of the cafeteria plan providing for the adjustment of an employee's compensation or an employee's receipt of any other benefits on the basis of the assistance or reimbursements received by the employee are considered in determining whether a dependent care benefit is a dependent care assistance program under section 129.

(j) *Section 137 rules for adoption assistance program offered through a cafeteria plan*—(1) *General rule.* In order for adoption assistance to be a qualified benefit that is excludible from gross income if elected through a cafeteria plan, the cafeteria plan must satisfy section 125 and the adoption assistance must satisfy section 137.

(2) *Adoption assistance in general.* Section 137(a) provides an employee with an exclusion from gross income for amounts paid or expenses incurred by the employer for qualified adoption expenses in connection with an employee's adoption of a child, if the amounts are paid or incurred through an adoption assistance program. Certain limits on amount of expenses and employee's income apply.

(3) *Reimbursement exclusively for adoption assistance.* Rules and requirements similar to the rules and requirements in paragraph (i)(3) of this section for dependent care assistance apply to adoption assistance.

(k) *FSAs and the rules governing the tax-favored treatment of employer-provided health benefits*—(1) *Medical expenses.* Health plans that are flexible spending arrangements, as defined in paragraph (a)(1) of this section, must conform to the generally applicable rules under sections 105 and 106 in order for the coverage and reimbursements under such plans to qualify for tax-favored treatment under such sections. Thus, health FSAs must qualify as accident and health plans. See paragraph (n) in §1.125–1. A health FSA is only permitted to reimburse medical expenses as defined in section 213(d). Thus, for example, a health FSA is not permitted to reimburse dependent care expenses.

(2) *Limiting payment or reimbursement to certain section 213(d) medical expenses.* A health FSA is permitted to limit payment or reimbursement to only

certain section 213(d) medical expenses (except health insurance, long-term care services or insurance). See paragraph (q) in §1.125–1. For example, a health FSA in a cafeteria plan is permitted to provide in the written plan that the plan reimburses all section 213(d) medical expenses allowed to be paid or reimbursed under a cafeteria plan except over-the-counter drugs.

(3) *Application of prohibition against deferred compensation to medical expenses.* (i) *Certain advance payments for orthodontia permitted.* A cafeteria plan is permitted, but is not required to, reimburse employees for orthodontia services before the services are provided but only to the extent that the employee has actually made the payments in advance of the orthodontia services in order to receive the services. These orthodontia services are deemed to be incurred when the employee makes the advance payment. Reimbursing advance payments does not violate the prohibition against deferring compensation.

(ii) *Example.* The following example illustrates the rules in paragraph (k)(3):

Example. Advance payment to orthodontist. Employer D sponsors a calendar year cafeteria plan which offers a health FSA. Employee K elects to salary reduce $3,000 for a health FSA for the 2009 plan year. Employee K's dependent requires orthodontic treatment. K's accident and health insurance does not cover orthodontia. The orthodontist, following the normal practice, charges $3,000, all due in 2009, for treatment, to begin in 2009 and end in 2010. K pays the $3,000 in 2009. In 2009, Employer D's cafeteria plan may reimburse $3,000 to K, without violating the prohibition against deferring compensation in section 125(d)(2).

(iii) *Reimbursements for durable medical equipment.* A health FSA in a cafeteria plan that reimburses employees for equipment (described in section 213(d)) with a useful life extending beyond the period of coverage during which the expense is incurred does not provide deferred compensation. For example, a health FSA is permitted to reimburse the cost of a wheelchair for an employee.

(4) *No reimbursement of premiums for accident and health insurance or long-term care insurance or services.* A health FSA is not permitted to treat employees' premium payments for other health coverage as reimbursable expenses. Thus, for example, a health FSA is not permitted to reimburse employees for payments for other health plan coverage, including premiums for COBRA coverage, accidental death and dismemberment insurance, long-term disability or short-term disability insurance or for health coverage under a plan maintained by the employer of the employee or the employer of the employee's spouse or dependent. Also, a health FSA is not permitted to reimburse expenses for long-term care insurance premiums or for long-term care services for the employee or employee's spouse or dependent. See paragraph (q) in §1.125–1 for nonqualified benefits.

(l) *Section 105(h) requirements.* Section 105(h) applies to health FSAs. Section 105(h) provides that the exclusion provided by section 105(b) is not available with respect to certain amounts received by a highly compensated individual (as defined in section 105(h)(5)) from a discriminatory self-insured medical reimbursement plan, which includes health FSAs. See §1.105–11. For purposes of section 105(h), coverage by a self-insured accident and health plan offered through a cafeteria plan is an optional benefit (even if only one level and type of coverage is offered) and, for purposes of the optional benefit rule in §1.105–11(c)(3)(i), employer contributions are treated as employee contributions to the extent that taxable benefits are offered by the plan.

(m) *HSA-compatible FSAs-limited-purpose health FSAs and post-deductible health FSAs*—(1) *In general. Limited-purpose health FSAs* and *post-deductible health FSAs* which satisfy all the requirements of section 125 are permitted to be offered through a cafeteria plan.

(2) *HSA-compatible FSAs.* Section 223(a) allows a deduction for certain contributions to a "Health Savings Account" (HSA) (as defined in section 223(d)). An *eligible individual* (as defined in section 223(c)(1)) may contribute to an HSA. An eligible individual must be covered under a "high deductible health plan" (HDHP) and not, while covered under an HDHP, under any health plan which is not an HDHP. A general purpose health FSA is not an HDHP and an individual covered by a general purpose health FSA is not eligible to contribute to an HSA. However, an individual covered by an HDHP (and who otherwise satisfies section 223(c)(1)) does not fail to be an eligible individual merely because the individual is also covered by a limited-purpose health FSA or post-deductible health FSA (as defined in this paragraph (m)) or a combination of a limited-purpose health FSA and a post-deductible health FSA.

(3) *Limited-purpose health FSA.* A limited-purpose health FSA is a health FSA described in the cafeteria plan that only pays or reimburses permitted coverage benefits (as defined in section 223(c)(2)(C)), such as vision care, dental care or preventive care (as defined for purposes of section 223(c)(2)(C)). See paragraph (k) in this section.

(4) *Post-deductible health FSA*—(i) *In general.* A post-deductible health FSA is a health FSA described in the cafeteria plan that only pays or reimburses medical expenses (as defined in section 213(d)) for preventive care or medical expenses incurred after the minimum annual HDHP deductible under section 223(c)(2)(A)(i) is satisfied. See paragraph (k) in this section. No medical expenses incurred before the annual HDHP deductible is satisfied may be reimbursed by a post-deductible FSA, regardless of whether the HDHP covers the expense or whether the deductible is later satisfied. For example, even if chiropractic care is not covered under the HDHP, expenses for chiropractic care incurred before the HDHP deductible is satisfied are not reimbursable at any time by a post-deductible health FSA.

(ii) *HDHP and health FSA deductibles.* The deductible for a post-deductible health FSA need not be the same amount as the deductible for the HDHP, but in no event may the post-deductible health FSA or other coverage provide benefits before the minimum annual HDHP deductible under section 223(c)(2)(A)(i) is satisfied (other than benefits permitted under a limited-purpose health FSA). In addition, although the deductibles of the HDHP and the other coverage may be satisfied independently by separate expenses, no benefits may be paid before the minimum annual deductible under section 223(c)(2)(A)(i) has been satisfied. An individual covered by a post-deductible health FSA (if otherwise an eligible individual) is an eligible individual for the purpose of contributing to the HSA.

(5) *Combination of limited-purpose health FSA and post-deductible health FSA.* An FSA is a combination of a limited-purpose health FSA and post-deductible health FSA if each of the benefits and reimbursements provided under the FSA are permitted under either a

limited-purpose health FSA or post-deductible health FSA. For example, before the HDHP deductible is satisfied, a combination limited-purpose and post-deductible health FSA may reimburse only preventive, vision or dental expenses. A combination limited-purpose and post-deductible health FSA may also reimburse any medical expense that may otherwise be paid by an FSA (that is, no insurance premiums or long-term care benefits) that is incurred after the HDHP deductible is satisfied.

(6) *Substantiation.* The substantiation rules in this section apply to limited-purpose health FSAs and to post-deductible health FSAs. In addition to providing third-party substantiation of medical expenses, a participant in a post-deductible health FSA must provide information from an independent third party that the HDHP deductible has been satisfied. A participant in a limited-purpose health FSA must provide information from an independent third-party that the medical expenses are for vision care, dental care or preventive care.

(7) *Plan amendments.* See paragraph (c) in §1.125–1 on the required effective date for amendments adopting or changing limited-purpose, post-deductible or combination limited-purpose and post-deductible health FSAs.

(n) *Qualified HSA distributions*—(1) *In general.* A health FSA in a cafeteria plan is permitted to offer employees the right to elect qualified HSA distributions described in section 106(e). No qualified HSA distribution may be made in a plan year unless the employer amends the health FSA written plan with respect to all employees, effective by the last day of the plan year, to allow a qualified HSA distribution satisfying all the requirements in this paragraph (n). See also section 106(e)(5)(B). In addition, a distribution with respect to an employee is not a qualified HSA distribution unless all of the following the requirements are satisfied—

(i) No qualified HSA distribution has been previously made on behalf of the employee from this health FSA;

(ii) The employee elects to have the employer make a qualified HSA distribution from the health FSA to the HSA of the employee;

(iii) The distribution does not exceed the lesser of the balance of the health FSA on—

(A) September 21, 2006; or

(B) The date of the distribution;

(iv) For purposes of this paragraph (n)(1), balances as of any date are determined on a cash basis, without taking into account expenses incurred but not reimbursed as of a date, and applying the uniform coverage rule in paragraph (d) in this section;

(v) The distribution is made no later than December 31, 2011; and

(vi) The employer makes the distribution directly to the trustee of the employee's HSA.

(2) *Taxation of qualified HSA distributions.* A qualified HSA distribution from the health FSA covering the participant to his or her HSA is a rollover to the HSA (as defined in section 223(f)(5)) and thus is generally not includible in gross income. However, if the participant is not an eligible individual (as defined in section 223(c)(1)) at any time during a testing period following the qualified HSA distribution, the amount of the distribution is includible in the participant's gross income and he or she is also subject to an additional 10 percent tax (with certain exceptions). Section 106(e)(3).

(3) *No effect on health FSA elections, coverage, use-or-lose rule.* A qualified HSA distribution does not alter an employee's irrevocable election under paragraph (a) of §1.125–2, or constitute a change in status under §1.125–4(a). If a qualified HSA distribution is made to an employee's HSA, even if the balance in a health FSA is reduced to zero, the employee's health FSA coverage continues to the end of the plan year. Unused benefits and contributions remaining at the end of a plan year (or at the end of a grace period, if applicable) must be forfeited.

(o) *FSA experience gains or forfeitures*—(1) *Experience gains in general.* An FSA experience gain (sometimes referred to as forfeitures in the use-or-lose rule in paragraph (c) in this section) with respect to a plan year (plus any grace period following the end of a plan year described in paragraph (e) in §1.125–1), equals the amount of the employer contributions, including salary reduction contributions, and after-tax employee contributions to the FSA minus the FSA's total claims reimbursements for the year. Experience gains (or forfeitures) may be—

(i) Retained by the employer maintaining the cafeteria plan; or

(ii) If not retained by the employer, may be used only in one or more of the following ways—

(A) To reduce required salary reduction amounts for the immediately following plan year, on a reasonable and uniform basis, as described in paragraph (o)(2) of this section;

(B) Returned to the employees on a reasonable and uniform basis, as described in paragraph (o)(2) of this section; or

(C) To defray expenses to administer the cafeteria plan.

(2) *Allocating experience gains among employees on reasonable and uniform basis.* If not retained by the employer or used to defray expenses of administering the plan, the experience gains must be allocated among employees on a reasonable and uniform basis. It is permissible to allocate these amounts based on the different coverage levels of employees under the FSA. Experience gains allocated in compliance with this paragraph (o) are not a deferral of the receipt of compensation. However, in no case may the experience gains be allocated among employees based (directly or indirectly) on their individual claims experience. Experience gains may not be used as contributions directly or indirectly to any deferred compensation benefit plan.

(3) *Example.* The following example illustrates the rules in this paragraph (o):

Example. Allocating experience gains. (i) Employer L maintains a cafeteria plan for its 1,200 employees, who may elect one of several different annual coverage levels under a health FSA in $100 increments from $500 to $2,000.

(ii) For the 2009 plan year, 1,000 employees elect levels of coverage under the health FSA. For the 2009 plan year, the health FSA has an experience gain of $5,000.

(iii) The $5,000 may be allocated to all participants for the plan year on a *per capita* basis weighted to reflect the participants' elected levels of coverage.

(iv) Alternatively, the $5,000 may be used to reduce the required salary reduction amount under the health FSA for all 2009 participants (for example, a $500 health FSA for the next year is priced at $480) or to reimburse claims incurred above the elective limit in 2010 as long as such reimbursements are made on a reasonable and uniform level.

(p) *Effective/applicability date.* It is proposed that these regulations apply on and after plan years beginning on or after January 1, 2009.

§1.125–6 Substantiation of expenses for all cafeteria plans.

(a) *Cafeteria plan payments and reimbursements*—(1) *In general.* A cafeteria plan may pay or reimburse only those substantiated expenses for qualified benefits incurred on or after the later of the effective date of the cafeteria plan and the date the employee is enrolled in the plan. This requirement applies to all qualified benefits offered through the cafeteria plan. See paragraph (b) of this section for substantiation rules.

(2) *Expenses incurred.* (i) *Employees' medical expenses must be incurred during the period of coverage.* In order for reimbursements to be excludible from gross income under section 105(b), the medical expenses reimbursed by an accident and health plan elected through a cafeteria plan must be incurred during the period when the participant is covered by the accident and health plan. A participant's period of coverage includes COBRA coverage. See §54.4980B–2 of this chapter. Medical expenses incurred before the later of the effective date of the plan and the date the employee is enrolled in the plan are not incurred during the period for which the employee is covered by the plan. However, the actual reimbursement of covered medical care expenses may be made after the applicable period of coverage.

(ii) *When medical expenses are incurred.* For purposes of this rule, medical expenses are incurred when the employee (or the employee's spouse or dependents) is provided with the medical care that gives rise to the medical expenses, and not when the employee is formally billed, charged for, or pays for the medical care.

(iii) *Example.* The following example illustrates the rules in this paragraph (a)(2):

Example. Medical expenses incurred after termination. (i) Employer E maintains a cafeteria plan with a calendar year plan year. The cafeteria plan provides that participation terminates when an individual ceases to be an employee of Employer E, unless the former employee elects to continue to participate in the health FSA under the COBRA rules in §54.4980B–2 of this chapter. Employee G timely elects to salary reduce $1,200 to participate in a health FSA for the 2009 plan year. As of June 30, 2009, Employee G has contributed $600 toward the health FSA, but incurred no medical expenses. On June 30, 2009, Employee G terminates employment and does not continue participation under COBRA. On July 15, 2009, G incurs a section 213(d) medical expense of $500.

(ii) Under the rules in paragraph (a)(2) of this section, the cafeteria plan is prohibited from reimbursing any portion of the $500 medical expense because, at the time the medical expense is incurred, G is not a participant in the cafeteria plan.

(3) *Section 105(b) requirements for reimbursement of medical expenses through a cafeteria plan.* (i) *In general.* In order for medical care reimbursements paid to an employee through a cafeteria plan to be excludible under section 105(b), the reimbursements must be paid pursuant to an employer-funded *accident and health plan*, as defined in section 105(e) and §§1.105–2 and 1.105–5.

(ii) *Reimbursement exclusively for section 213(d) medical expenses.* A cafeteria plan benefit through which an employee receives reimbursements of medical expenses is excludable under section 105(b) only if reimbursements from the plan are made specifically to reimburse the employee for medical expenses (as defined in section 213(d)) incurred by the employee or the employee's spouse or dependents during the period of coverage. Amounts paid to an employee as reimbursement are not paid specifically to reimburse the employee for medical expenses if the plan provides that the employee is entitled, or operates in a manner that entitles the employee, to receive the amounts, in the form of cash (for example, routine payment of salary) or any other taxable or nontaxable benefit irrespective of whether the employee (or the employee's spouse or dependents) incurs medical expenses during the period of coverage. This rule applies even if the employee will not receive such amounts until the end or after the end of the period. A plan under which employees (or their spouses and dependents) will receive reimbursement for medical expenses up to a specified amount and, if they incur no medical expenses, will receive cash or any other benefit in lieu of the reimbursements is not a benefit qualifying for the exclusion under sections 106 and 105(b). See §1.105–2. This is the case without regard to whether the benefit was purchased with contributions made at the employer's discretion, at the employee's discretion (for example, by salary reduction election), or pursuant to a collective bargaining agreement.

(iii) *Other arrangements.* Arrangements formally outside of the cafeteria plan that adjust an employee's compensation or an employee's receipt of any other benefits on the basis of the expenses incurred or reimbursements the employee receives are considered in determining whether the reimbursements are through a plan eligible for the exclusions under sections 106 and 105(b).

(4) *Reimbursements of dependent care expenses.* (i) *Dependent care expenses must be incurred.* In order to satisfy section 129, dependent care expenses may not be reimbursed before the expenses are incurred. For purposes of this rule, dependent care expenses are incurred when the care is provided and not when the employee is formally billed, charged for, or pays for the dependent care.

(ii) *Dependent care provided during the period of coverage.* In order for dependent care assistance to be provided through a dependent care assistance program eligible for the section 129 exclusion, the care must be provided to or on behalf of the employee during the period for which the employee is covered by the program. For example, if for a plan year, an employee elects a dependent care assistance program providing for reimbursement of dependent care expenses, only reimbursements for dependent care expenses incurred during that plan year are provided from a dependent care assistance program within the scope of section 129. Also, for purposes of this rule, expenses incurred before the later of the program's effective date and the date the employee is enrolled in the program are not incurred during the period when the employee is covered by the program. Similarly, if the dependent care assistance program furnishes the dependent care in-kind (for example, through an employer-maintained child care facility), only dependent care provided during the plan year of coverage is provided through a dependent care assistance program within the meaning of section 129. See also §1.125–5 for FSA rules.

(iii) *Period of coverage.* In order for dependent care assistance through a cafeteria plan to be provided through a dependent care assistance program eligible for the section 129 exclusion, the plan may not operate in a manner that enables employees to purchase dependent care assistance only for periods during which the employees expect to receive dependent care assistance. If the period of coverage for a dependent care assistance program offered

through a cafeteria plan is twelve months (or, in the case of a short plan year, at least equal to the short plan year) and the plan does not permit an employee to elect specific amounts of coverage, reimbursement, or salary reduction for less than twelve months, the plan is deemed not to operate to enable employees to purchase coverage only for periods when dependent care assistance will be received. See paragraph (a) in §1.125–2 and §1.125–4 regarding the revocation of elections during the period of coverage on account of changes in family status. See paragraph (e) in this section for required period of coverage for dependent care assistance.

(iv) *Examples.* The following examples illustrate the rules in paragraphs (a)(4)(i)-(iii) of this section:

Example 1. Initial non-refundable fee for child care. (i) Employer F maintains a calendar year cafeteria plan, offering employees an election between cash and qualified benefits, including dependent care assistance. Employee M has a one-year old dependent child. Employee M timely elected $5,000 of dependent care assistance for 2009. During the entire 2009 plan year, Employee M satisfies all the requirements in section 129 for dependent care assistance.

(ii) On February 1, 2009, Employee M pays an initial non-refundable fee of $500 to a licensed child care center (unrelated to Employer F or to Employee M), to reserve a space at the child care center for M's child. The child care center's monthly charges for child care are $1,200. When the child care center first begins to care for M's child, the $500 non-refundable fee is applied toward the first month's charges for child care.

(iii) On March 1, 2009, the child care center begins caring for Employee M's child, and continues to care for the child through December 31, 2009. On March 1, 2009, M pays the child care center $700 (the balance of the $1,200 in charges for child care to be provided in March 2009). On April 1, 2009, M pays the child care center $1,200 for the child care to be provided in April 2009.

(iv) Dependent care expenses are incurred when the services are provided. For dependent care services provided in March 2009, the $500 nonrefundable fee paid on February 1, 2009, and the $700 paid on March 1, 2009 may be reimbursed on or after the later of the date when substantiated or April 1, 2009. For dependent care services provided in April 2009, the $1,200 paid on April 1, 2009 may be reimbursed on or after the later of the date when substantiated or May 1, 2009.

Example 2. Non-refundable fee forfeited. Same facts as *Example 1*, except that the child care center never cared for M's child (who was instead cared for at Employer F's onsite child care facility). Because the child care center never provided child care services to Employee M's child, the $500 non-refundable fee is not reimbursable.

(v) *Optional spend-down provision.* At the employer's option, the written cafeteria plan may provide that dependent care expenses incurred after the date an employee ceases participation in the cafeteria plan (for example, after termination) and through the last day of that plan year (or grace period immediately after that plan year) may be reimbursed from unused benefits, if all of the requirements of section 129 are satisfied.

(vi) *Example.* The following example illustrates the rules in paragraph (a)(4)(v) of this section:

Example. Terminated employee's post-termination dependent care expenses. (i) For calendar year 2009, Employee X elects $5,000 salary reduction for dependent care assistance through Employer G's cafeteria plan. X works for Employer G from January 1 through June 30, 2009, when X terminates employment. As of June 30, 2009, X had paid $2,500 in salary reduction and had incurred and was reimbursed for $2,000 of dependent care expenses.

(ii) X does not work again until October 1, 2009, when X begins work for Employer H. X was employed by Employer H from October 1, 2009 through December 31, 2009. During this period, X also incurred $500 of dependent care expenses. During all the periods of employment in 2009, X satisfied all requirements in section 129 for excluding payments for dependent care assistance from gross income.

(iii) Employer G's cafeteria plan allows terminated employees to "spend down" unused salary reduction amounts for dependent care assistance, if all requirements of section 129 are satisfied. After X's claim for $500 of dependent care expenses is substantiated, Employer G's cafeteria plan reimburses X for $500 (the remaining balance) of dependent care expenses incurred during X's employment for Employer H between October 1, 2009 and December 31, 2009. Employer G's cafeteria plan and operation are consistent with section 125.

(b) *Rules for claims substantiation for cafeteria plans*—(1) *Substantiation required before reimbursing expenses for qualified benefits.* This paragraph (b) sets forth the substantiation requirements that a cafeteria plan must satisfy before paying or reimbursing any expense for a qualified benefit.

(2) *All claims must be substantiated.* As a precondition of payment or reimbursement of expenses for qualified benefits, a cafeteria plan must require substantiation in accordance with this section. Substantiating only a percentage of claims, or substantiating only claims above a certain dollar amount, fails to comply with the substantiation requirements in §1.125–1 and this section.

(3) *Substantiation by independent third-party.* (i) *In general.* All expenses must be substantiated by information from a third-party that is independent of the employee and the employee's spouse and dependents. The independent third-party must provide information describing the service or product, the date of the service or sale, and the amount. Self-substantiation or self-certification of an expense by an employee does not satisfy the substantiation requirements of this paragraph (b). The specific requirements in sections 105(b), 129, and 137 must also be satisfied as a condition of reimbursing expenses for qualified benefits. For example, a health FSA does not satisfy the requirements of section 105(b) if it reimburses employees for expenses where the employees only submit information describing medical expenses, the amount of the expenses and the date of the expenses but fail to provide a statement from an independent third-party (either automatically or subsequent to the transaction) verifying the expenses. Under §1.105–2, all amounts paid under a plan that permits self-substantiation or self-certification are includible in gross income, including amounts reimbursed for medical expenses, whether or not substantiated. See paragraph (m) in §1.125–5 for additional substantiation rules for limited-purpose and post-deductible health FSAs.

(ii) *Rules for substantiation of health FSA claims using an explanation of benefits provided by an insurance company.* (A) *Written statement from an independent third-party.* If the employer is provided with information from an independent third-party (such as an "*explanation of benefits*" (*EOB*) from an insurance company) indicating the date of the section 213(d) medical care and the employee's responsibility for payment for that medical care (that is, coinsurance payments and amounts below the plan's deductible), and the employee certifies that any expense paid through the health FSA has not been reimbursed and that the employee will not seek reimbursement from any other plan covering health benefits, the claim is fully substantiated without the need for submission of a receipt by the employee or further review.

(B) *Example.* The following example illustrates the rules in this paragraph (b)(3):

Example. Explanation of benefits. (i) During the plan year ending December 31, 2009, Employee Q is a participant in the health FSA sponsored by Employer J and is enrolled in Employer J's accident and health plan.

(ii) On March 1, 2009, Q visits a physician's office for medical care as defined in section 213(d). The charge for the physician's services is $150. Under the plan, Q is responsible for 20 percent of the charge for the physician's services (that is, $30). Q has sufficient FSA coverage for the $30 claim.

(iii) Employer J has coordinated with the accident and health plan so that Employer J or its agent automatically receives an EOB from the plan indicating that Q is responsible for payment of 20 percent of the $150 charged by the physician. Because Employer J has received a statement from an independent third-party that Q has incurred a medical expense, the date the expense was incurred, and the amount of the expense, the claim is substantiated without the need for J to submit additional information regarding the expense. Employer J's FSA reimburses Q the $30 medical expense without requiring Q to submit a receipt or a statement from the physician. The substantiation rules in paragraph (b) in this section are satisfied.

(4) *Advance reimbursement of expenses for qualified benefits prohibited.* Reimbursing expenses before the expense has been incurred or before the expense is substantiated fails to satisfy the substantiation requirements in §1.105–2, §1.125–1 and this section.

(5) *Purported loan from employer to employee.* In determining whether, under all the facts and circumstances, employees are being reimbursed for unsubstantiated claims, special scrutiny will be given to other arrangements such as employer-to-employee loans based on actual or projected employee claims.

(6) *Debit cards.* For purposes of this section, a *debit card* is a debit card, credit card, or stored value card. See also paragraphs (c) through (g) of this section for additional rules on payments or reimbursements made through debit cards.

(c) *Debit cards-overview*—(1) *Mandatory rules for all debit cards usable to pay or reimburse medical expenses.* Paragraph (d) of this section sets forth the mandatory procedures for debit cards to substantiate section 213(d) medical expenses. These rules apply to all debit cards used to pay or reimburse medical expenses. Paragraph (e) of this section sets forth additional substantiation rules that may be used for medical expenses incurred at medical care providers and certain stores with the Drug Stores and Pharmacies merchant category code. Paragraph (f) in this section sets forth the requirements for an inventory information approval system which must be used to substantiate medical expenses incurred at merchants or service providers that are not medical care providers or certain stores with the Drug Stores and Pharmacies merchant category code and that may be used for medical expenses incurred at all merchants.

(2) *Debit cards used for dependent care assistance.* Paragraph (g) of this section sets forth additional rules for debit cards usable for reimbursing dependent care expenses.

(3) *Additional guidance.* The Commissioner may prescribe additional guidance of general applicability, published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(*b*) of this chapter), to provide additional rules for debit cards.

(d) *Mandatory rules for all debit cards usable to pay or reimburse medical expenses.* A health FSA paying or reimbursing section 213(d) medical expenses through a debit card must satisfy all of the following requirements—

(1) Before any employee participating in a health FSA receives the debit card, the employee agrees in writing that he or she will only use the card to pay for medical expenses (as defined in section 213(d)) of the employee or his or her spouse or dependents, that he or she will not use the debit card for any medical expense that has already been reimbursed, that he or she will not seek reimbursement under any other health plan for any expense paid for with a debit card, and that he or she will acquire and retain sufficient documentation (including invoices and receipts) for any expense paid with the debit card.

(2) The debit card includes a statement providing that the agreements described in paragraph (d)(1) of this section are reaffirmed each time the employee uses the card.

(3) The amount available through the debit card equals the amount elected by the employee for the health FSA for the cafeteria plan year, and is reduced by amounts paid or reimbursed for section 213(d) medical expenses incurred during the plan year.

(4) The debit card is automatically cancelled when the employee ceases to participate in the health FSA.

(5) The employer limits use of the debit card to—

(i) Physicians, dentists, vision care offices, hospitals, other medical care providers (as identified by the merchant category code);

(ii) Stores with the merchant category code for Drugstores and Pharmacies if, on a location by location basis, 90 percent of the store's gross receipts during the prior taxable year consisted of items which qualify as expenses for medical care described in section 213(d); and

(iii) Stores that have implemented the inventory information approval system under paragraph (f).

(6) The employer substantiates claims based on payments to medical care providers and stores described in paragraphs (d)(5)(i) and (ii) of this section in accordance with either paragraph (e) or paragraph (f) of this section.

(7) The employer follows all of the following correction procedures for any improper payments using the debit card—

(i) Until the amount of the improper payment is recovered, the debit card must be de-activated and the employee must request payments or reimbursements of medical expenses from the health FSA through other methods (for example, by submitting receipts or invoices from a merchant or service provider showing the employee incurred a section 213(d) medical expense);

(ii) The employer demands that the employee repay the cafeteria plan an amount equal to the improper payment;

(iii) If, after the demand for repayment of improper payment (as described in paragraph (d)(7)(ii) of this section), the employee fails to repay the amount of the improper charge, the employer withholds the amount of the improper charge from the employee's pay or other compensation, to the full extent allowed by applicable law;

(iv) If any portion of the improper payment remains outstanding after attempts to recover the amount (as described in paragraph (d)(7)(ii) and (iii) of this section), the employer applies a claims substitution or offset to resolve improper payments, such as a reimbursement for a later substantiated expense claim is reduced by the amount of the improper payment. So, for example, if an employee has received an improper payment of $200 and subsequently submits a substantiated claim for $250 incurred during the same coverage period, a reimbursement for $50 is made; and

(v) If, after applying all the procedures described in paragraph (d)(7)(ii) through (iv) of this section, the employee remains

indebted to the employer for improper payments, the employer, consistent with its business practice, treats the improper payment as it would any other business indebtedness.

(e) *Substantiation of expenses incurred at medical care providers and certain other stores with Drug Stores and Pharmacies merchant category code*—(1) *In general*. A health FSA paying or reimbursing section 213(d) medical expenses through a debit card is permitted to comply with the substantiation provisions of this paragraph (e), instead of complying with the provisions of paragraph (f), for medical expenses incurred at providers described in paragraph (e)(2) of this section.

(2) *Medical care providers and certain other stores with Drug Stores and Pharmacies merchant category code*. Medical expenses may be substantiated using the methods described in paragraph (e)(3) of this section if incurred at physicians, pharmacies, dentists, vision care offices, hospitals, other medical care providers (as identified by the merchant category code) and at stores with the Drug Stores and Pharmacies merchant category code, if, on a store location-by-location basis, 90 percent of the store's gross receipts during the prior taxable year consisted of items which qualify as expenses for medical care described in section 213(d).

(3) *Claims substantiation for copayment matches, certain recurring medical expenses and real-time substantiation*. If all of the requirements in this paragraph (e)(3) are satisfied, copayment matches, certain recurring medical expenses and medical expenses substantiated in real-time are substantiated without the need for submission of receipts or further review.

(i) *Matching copayments—multiples of five or fewer*. If an employer's accident or health plan covering the employee (or the employee's spouse or dependents) has copayments in specific dollar amounts, and the dollar amount of the transaction at a medical care provider equals an exact multiple of not more than five times the dollar amount of the copayment for the specific service (for example, pharmacy benefit copayment, copayment for a physician's office visit) under the accident or health plan covering the specific employee-cardholder, then the charge is fully substantiated without the need for submission of a receipt or further review.

(A) *Tiered copayments*. If a health plan has multiple copayments for the same benefit, (for example, tiered copayments for a pharmacy benefit), exact matches of multiples or combinations of up to five copayments are similarly fully substantiated without the need for submission of a receipt or further review.

(B) *Copayment match must be exact multiple*. If the dollar amount of the transaction is not an exact multiple of the copayment (or an exact match of a multiple or combination of different copayments for a benefit in the case of multiple copayments), the transaction must be treated as conditional pending confirmation of the charge, even if the amount is less than five times the copayment.

(C) *No match for multiple of six or more times copayment*. If the dollar amount of the transaction at a medical care provider equals a multiple of six or more times the dollar amount of the copayment for the specific service, the transaction must be treated as conditional pending confirmation of the charge by the submission of additional third-party information. See paragraph (d) of this section. In the case of a plan with multiple copayments for the same benefit, if the dollar amount of the transaction exceeds five times the maximum copayment for the benefit, the transaction must also be treated as conditional pending confirmation of the charge by the submission of additional third-party information. In these cases, the employer must require that additional third-party information, such as merchant or service provider receipts, be submitted for review and substantiation, and the third-party information must satisfy the requirements in paragraph (b)(3) of this section.

(D) *Independent verification of copayment required*. The copayment schedule required under the accident or health plan must be independently verified by the employer. Statements or other representations by the employee are not sufficient. Self-substantiation or self-certification of an employee's copayment in connection with copayment matching procedures through debit cards or otherwise does not constitute substantiation. If a plan's copayment matching system relies on an employee to provide a copayment amount without verification of the amount, claims have not been substantiated, and all amounts paid from the plan are included in gross income, including amounts paid for medical care whether or not substantiated. See paragraph (b) in this section.

(4) *Certain recurring medical expenses*. Automatic payment or reimbursement satisfies the substantiation rules in this paragraph (e) for payment of recurring expenses that match expenses previously approved as to amount, medical care provider and time period (for example, for an employee who refills a prescription drug on a regular basis at the same provider and in the same amount). The payment is substantiated without the need for submission of a receipt or further review.

(5) *Real-time substantiation*. If a third party that is independent of the employee and the employee's spouse and dependents (for example, medical care provider, merchant, or pharmacy benefit manager) provides, at the time and point of sale, information to verify to the employer (including electronically by email, the internet, intranet or telephone) that the charge is for a section 213(d) medical expense, the expense is substantiated without the need for further review.

(6) *Substantiation requirements for all other medical expenses paid or reimbursed through a health FSA debit card*. All other charges to the debit card (other than substantiated copayments, recurring medical expenses or real-time substantiation, or charges substantiated through the inventory information approval system described in paragraph (f) of this section) must be treated as conditional, pending substantiation of the charge through additional independent third-party information describing the goods or services, the date of the service or sale and the amount of the transaction. All such debit card payments must be substantiated, regardless of the amount of the payment.

(f) *Inventory information approval system*—(1) *In general*. An inventory information approval system that complies with this paragraph (f) may be used to substantiate payments made using a debit card, including payments at merchants and service providers that are not described in paragraph (e)(2) of this section. Debit card transactions using this system are fully substantiated without the need for

submission of a receipt by the employee or further review.

(2) *Operation of inventory information approval system.* An inventory information approval system must operate in the manner described in this paragraph (f)(2).

(i) When an employee uses the card, the payment card processor's or participating merchant's system collects information about the items purchased using the inventory control information (for example, *stock keeping units* (SKUs)). The system compares the inventory control information for the items purchased against a list of items, the purchase of which qualifies as expenses for medical care under section 213(d) (including nonprescription medications).

(ii) The section 213(d) medical expenses are totaled and the merchant's or payment card processor's system approves the use of the card only for the amount of the section 213(d) medical expenses eligible for coverage under the health FSA (taking into consideration the uniform coverage rule in paragraph (d) of §1.125–5);

(iii) If the transaction is only partially approved, the employee is required to tender additional amounts, resulting in a split-tender transaction. For example, if, after matching inventory information, it is determined that all items purchased are section 213(d) medical expenses, the entire transaction is approved, subject to the coverage limitations of the health FSA;

(iv) If, after matching inventory information, it is determined that only some of the items purchased are section 213(d) medical expenses, the transaction is approved only as to the section 213(d) medical expenses. In this case, the merchant or service-provider must request additional payment from the employee for the items that do not satisfy the definition of medical care under section 213(d);

(v) The merchant or service-provider must also request additional payment from the employee if the employee does not have sufficient health FSA coverage to purchase the section 213(d) medical items;

(vi) Any attempt to use the card at non-participating merchants or service-providers must fail.

(3) *Employer's responsibility for ensuring inventory information approval system's compliance with §1.105–2, §1.125–1, §1.125–6 and recordkeeping requirements.* An employer that uses the inventory information approval system must ensure that the inventory information approval system complies with the requirements in §§1.105–2, 1.125–1, and §1.125–6 for substantiating, paying or reimbursing section 213(d) medical expenses and with the recordkeeping requirements in section 6001.

(g) *Debit cards used to pay or reimburse dependent care assistance*—(1) *In general.* An employer may use a debit card to provide benefits under its dependent care assistance program (including a dependent care assistance FSA). However, dependent care expenses may not be reimbursed before the expenses are incurred. See paragraph (a)(4) in this section. Thus, if a dependent care provider requires payment before the dependent care services are provided, the expenses cannot be reimbursed at the time of payment through use of a debit card or otherwise.

(2) *Reimbursing dependent care assistance through a debit card.* An employer offering a dependent care assistance FSA may adopt the following method to provide reimbursements for dependent care expenses through a debit card—

(i) At the beginning of the plan year or upon enrollment in the dependent care assistance program, the employee pays initial expenses to the dependent care provider and substantiates the initial expenses by submitting to the employer or plan administrator a statement from the dependent care provider substantiating the dates and amounts for the services provided.

(ii) After the employer or plan administrator receives the substantiation (but not before the date the services are provided as indicated by the statement provided by the dependent care provider), the plan makes available through the debit card an amount equal to the lesser of—

(A) The previously incurred and substantiated expense; or

(B) The employee's total salary reduction amount to date.

(iii) The card may be used to pay for subsequently incurred dependent care expenses.

(iv) The amount available through the card may be increased in the amount of any additional dependent care expenses only after the additional expenses have been incurred.

(3) *Substantiating recurring dependent care expenses.* Card transactions that collect information matching expenses previously substantiated and approved as to dependent care provider and time period may be treated as substantiated without further review if the transaction is for an amount equal to or less than the previously substantiated expenses. Similarly, dependent care expenses previously substantiated and approved through nonelectronic methods may also be treated as substantiated without further review. In both cases, if there is an increase in previously substantiated amounts or a change in the dependent care provider, the employee must submit a statement or receipt from the dependent care provider substantiating the claimed expenses before amounts relating to the increased amounts or new providers may be added to the card.

(4) *Example.* The following example illustrates the rules in this paragraph (g):

Example. Recurring dependent care expenses. (i) Employer K sponsors a dependent care assistance FSA through its cafeteria plan. Salary reduction amounts for participating employees are made on a weekly payroll basis, which are available for dependent care coverage on a weekly basis. As a result, the amount of available dependent care coverage equals the employee's salary reduction amount minus claims previously paid from the plan. Employer K has adopted a payment card program for its dependent care FSA.

(ii) For the plan year ending December 31, 2009, Employee F is a participant in the dependent care FSA and elected $5,000 of dependent care coverage. Employer K reduces F's salary by $96.15 on a weekly basis to pay for coverage under the dependent care FSA.

(iii) At the beginning of the 2009 plan year, F is issued a debit card with a balance of zero. F's child-care provider, ABC Daycare Center, requires a $250 advance payment at the beginning of the week for dependent care services that will be provided during the week. The dependent care services provided for F by ABC qualify for reimbursement under section 129. However, because as of the beginning of the plan year, no services have yet been provided, F cannot be reimbursed for any of the amounts until the end of the first week of the plan year (that is, the week ending January 5, 2009), after the services have been provided.

(iv) F submits a claim for reimbursement that includes a statement from ABC with a description of the services, the amount of the services, and the dates of the services. Employer K increases the balance of F's payment card to $96.15 after the services have been provided (*i.e.*, the lesser of F's salary reduction to date or the incurred dependent care expenses). F uses the card to pay ABC $96.15 on the first day of the next week (January 8, 2009) and pays ABC the remaining balance due for that week ($153.85) by check.

(v) To the extent that this card transaction and each subsequent transaction is with ABC and is for

an amount equal to or less than the previously substantiated amount, the charges are fully substantiated without the need for the submission by F of a statement from the provider or further review by the employer. However, the subsequent amount is not made available on the card until the end of the week when the services have been provided. Employer K's dependent care debit card satisfies the substantiation requirements of this paragraph (g).

(h) *Effective/applicability date.* It is proposed that these regulations apply on and after plan years beginning on or after January 1, 2009. However, the effective dates for the previously issued guidance on debit cards, which is incorporated in this section, remain applicable.

§1.125–7 Cafeteria plan nondiscrimination rules

(a) *Definitions*—(1) *In general.* The definitions set forth in this paragraph (a) apply for purposes of section 125(b), (c), (e) and (g) and this section.

(2) *Compensation.* The term *compensation* means compensation as defined in section 415(c)(3).

(3) *Highly compensated individual.* (i) *In general.* The term *highly compensated individual* means an individual who is—

(A) An officer;

(B) A five percent shareholder (as defined in paragraph (a)(8) of this section); or

(C) Highly compensated.

(ii) *Spouse or dependent.* A spouse or a dependent of any highly compensated individual described in (a)(3)(i) of this section is a highly compensated individual. Section 125(e).

(4) *Highly compensated participant.* The term *highly compensated participant* means a highly compensated individual who is eligible to participate in the cafeteria plan.

(5) *Nonhighly compensated individual.* The term *nonhighly compensated individual* means an individual who is not a highly compensated individual.

(6) *Nonhighly compensated participant.* The term *nonhighly compensated participant* means a participant who is not a highly compensated participant.

(7) *Officer.* The term officer means any individual or participant who for the preceding plan year (or the current plan year in the case of the first year of employment) was an officer. Whether an individual is an *officer* is determined based on all the facts and circumstances, including the source of the individual's authority, the term for which he or she is elected or appointed, and the nature and extent of his or her duties. Generally, the term officer means an administrative executive who is in regular and continued service. The term officer implies continuity of service and excludes individuals performing services in connection with a special and single transaction. An individual who merely has the title of an officer but not the authority of an officer, is not an officer. Similarly, an individual without the title of an officer but who has the authority of an officer is an officer. Sole proprietorships, partnerships, associations, trusts and labor organizations also may have officers. See §§301.7701–1 through –3.

(8) *Five percent shareholder.* A *five percent shareholder* is an individual who in either the preceding plan year or current plan year owns more than five percent of the voting power or value of all classes of stock of the employer, determined without attribution.

(9) *Highly compensated.* The term *highly compensated* means any individual or participant who for the preceding plan year (or the current plan year in the case of the first year of employment) had compensation from the employer in excess of the compensation amount specified in section 414(q)(1)(B), and, if elected by the employer, was also in the top-paid group of employees (determined by reference to section 414(q)(3)) for such preceding plan year (or for the current plan year in the case of the first year of employment).

(10) *Key employee.* A *key employee* is a participant who is a key employee within the meaning of section 416(i)(1) at any time during the preceding plan year. A key employee covered by a collective bargaining agreement is a key employee.

(11) *Collectively bargained plan.* A *collectively bargained plan* is a plan or the portion of a plan maintained under an agreement which is a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that cafeteria plan benefits were the subject of good faith bargaining between such employee representatives and such employer or employers.

(12) *Year of employment.* For purposes of section 125(g)(3)(B)(i), a *year of employment* is determined by reference to the elapsed time method of crediting service. See §1.410(a)–7.

(13) *Premium-only-plan.* A premium-only-plan is described in paragraph (a)(5) in §1.125–1.

(14) *Statutory nontaxable benefits.* *Statutory nontaxable benefits* are qualified benefits that are excluded from gross income (for example, an employer-provided accident and health plan excludible under section 106 or a dependent care assistance program excludible under section 129). Statutory nontaxable benefits also include group-term life insurance on the life of an employee includible in the employee's gross income solely because the coverage exceeds the limit in section 79(a).

(15) *Total benefits.* *Total benefits* are qualified benefits and permitted taxable benefits.

(b) *Nondiscrimination as to eligibility*—(1) *In general.* A cafeteria plan must not discriminate in favor of highly compensated individuals as to eligibility to participate for that plan year. A cafeteria plan does not discriminate in favor of highly compensated individuals if the plan benefits a group of employees who qualify under a reasonable classification established by the employer, as defined in §1.410(b)–4(b), and the group of employees included in the classification satisfies the safe harbor percentage test or the unsafe harbor percentage component of the facts and circumstances test in §1.410(b)–4(c). (In applying the §1.410(b)–4 test, substitute highly compensated individual for highly compensated employee and substitute nonhighly compensated individual for nonhighly compensated employee).

(2) *Deadline for participation in cafeteria plan.* Any employee who has completed three years of employment (and who satisfies any conditions for participation in the cafeteria plan that are not related to completion of a requisite length of employment) must be permitted to elect to participate in the cafeteria plan no later than the first day of the first plan year beginning after the date the employee completed three years of employment (unless the employee separates from service before the first day of that plan year).

(3) *The safe harbor percentage test.* (i) *In general.* For purposes of the safe harbor percentage test and the unsafe harbor percentage component of the facts and cir-

cumstances test, if the cafeteria plan provides that only employees who have completed three years of employment are permitted to participate in the plan, employees who have not completed three years of employment may be excluded from consideration. However, if the cafeteria plan provides that employees are allowed to participate before completing three years of employment, all employees with less than three years of employment must be included in applying the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test. See paragraph (g) of this section for a permissive disaggregation rule.

(ii) *Employees excluded from consideration.* In addition, for purposes of the safe harbor percentage test and the unsafe harbor percentage component of the facts and circumstances test, the following employees are excluded from consideration —

(A) Employees (except key employees) covered by a collectively bargained plan as defined in paragraph (a)(11) of this section;

(B) Employees who are nonresident aliens and receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)); and

(C) Employees participating in the cafeteria plan under a COBRA continuation provision.

(iv) *Examples.* The following examples illustrate the rules in paragraph (b) of this section:

Example 1. Same qualified benefit for same salary reduction amount. Employer A has one employer-provided accident and health insurance plan. The cost to participants electing the accident and health plan is $10,000 per year for single coverage. All employees have the same opportunity to salary reduce $10,000 for accident and health plan. The cafeteria plan satisfies the eligibility test.

Example 2. Same qualified benefit for unequal salary reduction amounts. Same facts as *Example 1* except the cafeteria plan offers nonhighly compensated employees the election to salary reduce $10,000 to pay premiums for single coverage. The cafeteria plan provides an $8,000 employer flex-credit to highly compensated employees to pay a portion of the premium, and provides an election to them to salary reduce $2,000 to pay the balance of the premium. The cafeteria plan fails the eligibility test.

Example 3. Accident and health plans of unequal value. Employer B's cafeteria plan offers two employer-provided accident and health insurance plans: Plan X, available only to highly compensated participants, is a low-deductible plan. Plan Y, available only to nonhighly compensated participants, is a high deductible plan (as defined in section 223(c)(2)). The annual premium for single coverage under Plan X is $15,000 per year, and $8,000 per year for Plan Y. Employer B's cafeteria plan provides that highly compensated participants may elect salary reduction of $15,000 for coverage under Plan X, and that nonhighly compensated participants may elect salary reduction of $8,000 for coverage under Plan Y. The cafeteria plan fails the eligibility test.

Example 4. Accident and health plans of unequal value for unequal salary reduction amounts. Same facts as *Example 3*, except that the amount of salary reduction for highly compensated participants to elect Plan X is $8,000. The cafeteria plan fails the eligibility test.

(c) *Nondiscrimination as to contributions and benefits*—(1) *In general.* A cafeteria plan must not discriminate in favor of highly compensated participants as to contributions and benefits for a plan year.

(2) *Benefit availability and benefit election.* A cafeteria plan does not discriminate with respect to contributions and benefits if either qualified benefits and total benefits, or employer contributions allocable to statutory nontaxable benefits and employer contributions allocable to total benefits, do not discriminate in favor of highly compensated participants. A cafeteria plan must satisfy this paragraph (c) with respect to both benefit availability and benefit utilization. Thus, a plan must give each similarly situated participant a uniform opportunity to elect qualified benefits, and the actual election of qualified benefits through the plan must not be disproportionate by highly compensated participants (while other participants elect permitted taxable benefits). Qualified benefits are disproportionately elected by highly compensated participants if the aggregate qualified benefits elected by highly compensated participants, measured as a percentage of the aggregate compensation of highly compensated participants, exceed the aggregate qualified benefits elected by nonhighly compensated participants measured as a percentage of the aggregate compensation of nonhighly compensated participants. A plan must also give each similarly situated participant a uniform election with respect to employer contributions, and the actual election with respect to employer contributions for qualified benefits through the plan must not be disproportionate by highly compensated participants (while other participants elect to receive employer contributions as permitted taxable benefits). Employer contributions are disproportionately utilized by highly compensated participants if the aggregate contributions utilized by highly compensated participants, measured as a percentage of the aggregate compensation of highly compensated participants, exceed the aggregate contributions utilized by nonhighly compensated participants measured as a percentage of the aggregate compensation of nonhighly compensated participants.

(3) *Example.* The following example illustrates the rules in paragraph (c) of this section:

Example. Contributions and benefits test. Employer C's cafeteria plan satisfies the eligibility test in paragraph (b) of this section. Highly compensated participants in the cafeteria plan elect aggregate qualified benefits equaling 5 percent of aggregate compensation; nonhighly compensated participants elect aggregate qualified benefits equaling 10 percent of aggregate compensation. Employer C's cafeteria plan passes the contribution and benefits test.

(d) *Key employees*—(1) *In general.* If for any plan year, the statutory nontaxable benefits provided to key employees exceed 25 percent of the aggregate of statutory nontaxable benefits provided for all employees through the cafeteria plan, each key employee includes in gross income an amount equaling the maximum taxable benefits that he or she could have elected for the plan year. However, see safe harbor for premium-only-plans in paragraph (f) of this section.

(2) *Example.* The following example illustrates the rules in paragraph (d) of this section:

Example. (i) *Key employee concentration test.* Employer D's cafeteria plan offers all employees an election between taxable benefits and qualified benefits. The cafeteria plan satisfies the eligibility test in paragraph (b) of this section. Employer D has two key employees and four nonhighly compensated employees. The key employees each elect $2,000 of qualified benefits. Each nonhighly compensated employee also elects $2,000 of qualified benefits. The qualified benefits are statutory nontaxable benefits.

(ii) Key employees receive $4,000 of statutory nontaxable benefits and nonhighly compensated employees receive $8,000 of statutory nontaxable benefits, for a total of $12,000. Key employees receive 33 percent of statutory nontaxable benefits (4,000/12,000). Because the cafeteria plan provides more than 25 percent of the aggregate of statutory nontaxable benefits to key employees, the plan fails the key employee concentration test.

(e) *Safe harbor for cafeteria plans providing health benefits*—(1) *In general.* A

cafeteria plan that provides health benefits is not treated as discriminatory as to benefits and contributions if:

(i) Contributions under the plan on behalf of each participant include an amount which equals 100 percent of the cost of the health benefit coverage under the plan of the majority of the highly compensated participants similarly situated, or equals or exceeds 75 percent of the cost of the health benefit coverage of the participant (similarly situated) having the highest cost health benefit coverage under the plan, and

(ii) Contributions or benefits under the plan in excess of those described in paragraph (e)(1)(i) of this section bear a uniform relationship to compensation.

(2) *Similarly situated.* In determining which participants are similarly situated, reasonable differences in plan benefits may be taken into account (for example, variations in plan benefits offered to employees working in different geographical locations or to employees with family coverage versus employee-only coverage).

(3) *Health benefits.* Health benefits for purposes of this rule are limited to major medical coverage and exclude dental coverage and health FSAs.

(4) *Example.* The following example illustrates the rules in paragraph (e) of this section:

Example. (i) All 10 of Employer E's employees are eligible to elect between permitted taxable benefits and salary reduction of $8,000 per plan year for self-only coverage in the major medical health plan provided by Employer E. All 10 employees elect $8,000 salary reduction for the major medical plan.

(ii) The cafeteria plan satisfies the section 125(g)(2) safe harbor for cafeteria plans providing health benefits.

(f) *Safe harbor test for premium-only-plans*—(1) *In general.* A premium-only-plan (as defined in paragraph (a)(13) of this section) is deemed to satisfy the nondiscrimination rules in section 125(c) and this section for a plan year if, for that plan year, the plan satisfies the safe harbor percentage test for eligibility in paragraph (b)(3) of this section.

(2) *Example.* The following example illustrates the rules in paragraph (f) of this section:

Example. Premium-only-plan. (i) Employer F's cafeteria plan is a premium-only-plan (as defined in paragraph (a)(13) of this section). The written cafeteria plan offers one employer-provided accident and health plan and offers all employees the election to salary reduce same amount or same percentage of the premium for self-only or family coverage. All key employees and all highly compensated employees elect salary reduction for the accident and health plan, but only 20 percent of nonhighly compensated employees elect the accident and health plan.

(ii) The premium-only-plan satisfies the nondiscrimination rules in section 125(b) and (c) and this section.

(g) *Permissive disaggregation for nondiscrimination testing*—(1) *General rule.* If a cafeteria plan benefits employees who have not completed three years of employment, the cafeteria plan is permitted to test for nondiscrimination under this section as if the plan were two separate plans—

(i) One plan benefiting the employees who completed one day of employment but less than three years of employment; and

(ii) Another plan benefiting the employees who have completed three years of employment.

(2) *Disaggregated plans tested separately for eligibility test and contributions and benefits test.* If a cafeteria plan is disaggregated into two separate plans for purposes of nondiscrimination testing, the two separate plans must be tested separately for both the nondiscrimination as to eligibility test in paragraph (b) of this section and the nondiscrimination as to contributions and benefits test in paragraph (c) of this section.

(h) *Optional aggregation of plans for nondiscrimination testing.* An employer who sponsors more than one cafeteria plan is permitted to aggregate two or more of the cafeteria plans for purposes of nondiscrimination testing. If two or more cafeteria plans are aggregated into a combined plan for this purpose, the combined plan must satisfy the nondiscrimination as to eligibility test in paragraph (b) of this section and the nondiscrimination as to contributions and benefits test in paragraph (c) of this section, as though the combined plan were a single plan. Thus, for example, in order to satisfy the benefit availability and benefit election requirements in paragraph (c)(2) of this section, the combined plan must give each similarly situated participant a uniform opportunity to elect qualified benefits and the actual election of qualified benefits by highly compensated participants must not be disproportionate. However, if a principal purpose of the aggregation is to manipulate the nondiscrimination testing requirements or to otherwise discriminate in favor of highly compensated individuals or participants, the plans will not be permitted to be aggregated for nondiscrimination testing.

(i) *Employees of certain controlled groups.* All employees who are treated as employed by a single employer under section 414(b), (c), (m), or (o) are treated as employed by a single employer for purposes of section 125. Section 125(g)(4); section 414(t).

(j) *Time to perform nondiscrimination testing*—(1) *In general.* Nondiscrimination testing must be performed as of the last day of the plan year, taking into account all non-excludable employees (or former employees) who were employees on any day during the plan year.

(2) The following example illustrates the rules in paragraph (j) of this section:

Example. When to perform discrimination testing. (i) Employer H employs three employees and maintains a calendar year cafeteria plan. During the 2009 plan year, Employee J was an employee the entire calendar year, Employee K was an employee from May 1, through August 31, 2009, and Employee L worked from January 1, 2009 to April 15, 2009, when he retired.

(ii) Nondiscrimination testing for the 2009 plan year must be performed on December 31, 2009, taking into account employees J, K, and L's compensation in the preceding year.

(k) *Discrimination in actual operation prohibited.* In addition to not discriminating as to either benefit availability or benefit utilization, a cafeteria plan must not discriminate in favor of highly compensated participants in actual operation. For example, a plan may be discriminatory in actual operation if the duration of the plan (or of a particular nontaxable benefit offered through the plan) is for a period during which only highly compensated participants utilize the plan (or the benefit). See also the key employee concentration test in section 125(b)(2).

(l) *Anti-abuse rule*—(1) *Interpretation.* The provisions of this section must be interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of highly compensated individuals, highly compensated participants and key employees.

(2) *Change in plan testing procedures.* A plan will not be treated as satisfying the requirements of this section if there are repeated changes to plan testing procedures or plan provisions that have the effect of manipulating the nondiscrimination testing requirements of this section, if a principal purpose of the changes was to achieve this result.

(m) *Tax treatment of benefits in a cafeteria plan*—(1) *Nondiscriminatory cafeteria plan.* A participant in a nondiscriminatory cafeteria plan (including a highly compensated participant or key employee) who elects qualified benefits is not treated as having received taxable benefits offered through the plan, and thus the qualified benefits elected by the employee are not includible in the employee's gross income merely because of the availability of taxable benefits. But see paragraph (j) in §1.125–1 on nondiscrimination rules for sections 79(d), 105(h), 129(d), and 137(c)(2), and limitations on exclusion.

(2) *Discriminatory cafeteria plan.* A highly compensated participant or key employee participating in a discriminatory cafeteria plan must include in gross income (in the participant's taxable year within which ends the plan year with respect to which an election was or could have been made) the value of the taxable benefit with the greatest value that the employee could have elected to receive, even if the employee elects to receive only the nontaxable benefits offered.

(n) *Employer contributions to employees' Health Savings Accounts.* If an employer contributes to employees' Health Savings Accounts (HSAs) through a cafeteria plan (as defined in §54.4980G–5 of this chapter) those contributions are subject to the nondiscrimination rules in section 125 and this section and are not subject to the comparability rules in section 4980G. See §§54.4980G–0 through 54.4980G–5 of this chapter.

(o) *Effective/applicability date.* It is proposed that these regulations apply on and after plan years beginning on or after January 1, 2009.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

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Notice of Proposed Rulemaking and Notice of Public Hearing

Medical and Accident Insurance Benefits Under Qualified Plans

REG–148393–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under section 402(a) of the Internal Revenue Code (Code) regarding the tax treatment of payments by qualified plans for medical or accident insurance. These regulations would affect administrators of, participants in, and beneficiaries of qualified retirement plans. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 19, 2007. Outlines of topics to be discussed at the public hearing scheduled for December 6, 2007, at 10 a.m., must be received by November 15, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–148393–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–148393–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–148393–06). The public hearing will be held in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Pamela R. Kinard (202) 622–6060; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 402(a) of the Code, as well as conforming amendments under sections 72, 105, 106, 401, 402(c), 403(a), and 403(b).

Section 104(a)(3) provides, in general, that gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness. This exclusion does not apply to amounts attributable to (and not in excess of) deductions allowed under section 213 for any prior taxable year, or to other amounts received by an employee to the extent such amounts either are attributable to contributions by the employer that were not includible in the gross income of the employee or are paid by the employer.

Section 105(a) provides that, except as otherwise provided, amounts received by an employee through accident or health insurance for personal injuries or sickness are included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee or (2) are paid by the employer.

Section 105(b) generally provides that, except in the case of amounts attributable to deductions allowed under section 213 for any prior taxable year, gross income does not include amounts referred to in section 105(a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by the taxpayer for the medical care of the taxpayer and his or her spouse or dependents.

Section 106 provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan. Section 1.106–1 provides that the gross income of an employee does not include contributions that the employer makes to an accident or health plan for compensation (through insurance or a separate trust or fund) for personal injuries or sickness to the employee or the employee's spouse or dependents.

Section 7702B(a)(1) provides that, for purposes of the Code, a qualified long-term care insurance contract is treated as an accident and health insurance contract.

Section 213 generally allows a deduction for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his or her spouse, and dependents, to the extent that the expenses exceed 7.5 percent of the taxpayer's adjusted gross income. Section 213(d)(1) provides that the term "medical care" includes amounts paid for insurance covering medical care (including eligible long-term care premiums with respect to qualified long-term care insurance contracts).

Section 401(a) sets forth requirements for a trust forming part of a pension, profit-sharing, or stock bonus plan to be qualified under section 401(a).

Section 401(h) provides that a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents only if certain enumerated conditions are met. Those conditions include: (1) the aggregate actual contributions for medical benefits (when added to actual contributions for life insurance protection under the plan) may not exceed 25 percent of the total actual contributions to the plan (other than contributions to fund past service credits) after the date on which the account is established; (2) a separate account must be established and maintained for such benefits; (3) the employer's contributions to the separate account must be reasonable and ascertainable; (4) it must be impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits; (5) any amount remaining after satisfaction of all liabilities must, under the terms of the plan, be returned to the employer; and (6) special limitations for the accounts of key employees must be satisfied.

Section 402(a) provides, in general, that any amount actually distributed by a qualified plan is taxable under section 72 in the taxable year in which distributed.

Section 72(a) provides that, except as otherwise provided, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract. Sections 72(d) and (e) provide rules for determining the portion of any distribution that is not includable in gross income as a recovery of a participant's investment in the contract (generally the amount of the unrecovered after-tax employee contributions) under a qualified employer retirement plan.

Section 402(l), added by section 845(a) of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780) (PPA '06), provides a limited exclusion from gross income for distributions from an eligible retirement plan used to pay health or long-term care insurance premiums of an eligible retired public safety officer to the extent that the aggregate amount of the distributions for the taxable year is not in excess of the qualified health insurance premiums of the retired public safety officer and his or her spouse or dependents. The total amount excluded from gross income pursuant to section 402(l) shall not exceed $3,000.

Section 1.72–15 provides rules relating to the tax treatment of amounts paid from an employer-established plan to which section 72 applies and which provides for distributions of accident or health benefits. With respect to benefits that are attributable to employer contributions, §1.72–15(d) provides that any amount received as an accident or health benefit is includible in gross income, except to the extent excludable from gross income under section 105(b) (relating to reimbursements of medical care expenses as defined in section 213(d)).[1] Section 1.72–15(e) provides that the taxability of benefits that are not accident or health benefits is determined under section 72 without regard to any exclusion under section 104 or 105.

Section 1.401–1(b)(1)(i) provides that a plan is not a pension plan within the meaning of section 401(a) if it provides for the payment of benefits not customarily included in a pension plan such as layoff benefits or benefits for sickness, accident, hospitalization, or medical expenses (except for medical benefits described in section 401(h)). See §1.401(a)–1(b)(1)(ii).

Section 1.401–1(b)(1)(ii) provides that a profit-sharing plan within the meaning of section 401(a) is primarily a plan of deferred compensation, but that amounts allocated to the account of a participant may be used to provide incidental life or accident or health insurance for the participant and the participant's family. Section 1.401–1(b)(1)(iii) provides that a stock bonus plan is a plan established and maintained by the employer to provide benefits similar to those of a profit-sharing plan.

Rev. Rul. 61–164, 1961–2 C.B. 99, see §601.601(d)(2) of this chapter, holds that a profit-sharing plan does not violate the incidental benefit rule in §1.401–1(b)(1)(ii) merely because, in accordance with the terms of the plan, each participant's account under the plan is charged with the cost of health insurance for the participant under group hospitalization insurance for the employer's employees, provided that the total amount used for life or accident or health insurance for the employee and the employee's family is incidental. The ruling concludes that such insurance is treated as incidental if the amount expended does not exceed 25 percent of the funds allocated to a participant's account that have not been accumulated for the period prescribed by the plan for the deferment of distributions. The ruling also concludes that the use of profit-sharing plan funds to pay for medical insurance for a participant and his or her beneficiary is a distribution within the meaning of section 402.

Rev. Rul. 73–501, 1973–2 C.B. 127, see §601.601(d)(2) of this chapter, applies the incidental benefit rule to the purchase of life insurance by a profit-sharing plan. The ruling states that "[u]nder a qualified profit-sharing plan, the use of trust funds to pay the cost of life, accident, or health insurance for an employee is a distribution within the purview of section 402 of the Code."

Rev. Rul. 2003–62, 2003–1 C.B. 1034, see §601.601(d)(2) of this chapter, concludes that amounts distributed from a qualified retirement plan that the distributee elects to have applied to pay health

[1] Section 1.72–15(d) also refers to benefits excludible under section 105(c) (relating to certain payments unrelated to absence from work) or 105(d), which was repealed in 1983 (and which related to certain disability payments).

insurance premiums under a cafeteria plan are includible in the distributee's gross income. The ruling also holds that the same conclusion applies where amounts distributed from the plan are applied directly to reimburse medical care expenses incurred by a participant.

Rev. Rul. 2005–55, 2005–2 C.B. 284, see §601.601(d)(2) of this chapter, holds that a profit-sharing plan that provides a sub-account which permits distributions only for the purpose of reimbursing the participant for substantiated medical expenses imposes conditions on the entitlement of the participant to amounts held in the sub-account and, as a result of the conditions, does not meet the nonforfeitability requirements of section 411.

Explanation of Provisions

The proposed regulations would clarify that a payment from a qualified plan for an accident or health insurance premium generally constitutes a distribution under section 402(a) that is taxable to the distributee under section 72 in the taxable year in which the premium is paid. The taxable amount generally equals the amount of the premium charged against the participant's benefits under the plan. If a defined contribution plan pays these premiums from a current year contribution or forfeiture that has not been allocated to a participant's account, then the amount of the premium for each participant will be treated as first being allocated to the participant and then charged against the participant's benefits under the plan, so that the amount of the distribution is the same as determined under the preceding sentence.

These regulations would also provide that a distribution for the payment of the premiums by a qualified plan generally is not excluded from gross income under section 104, 105, or 106, but such distribution would constitute an amount paid for accident or health insurance under section 213. Furthermore, to the extent that the payment of premiums for accident or health insurance has been treated as a distribution from a qualified plan, amounts received through the accident or health insurance for personal injuries or sickness are excludable from gross income under section 104(a)(3) and are not treated as distributions from the plan.

A related issue is whether the purchase of accident and health insurance can be treated as if the trust merely purchased an investment under which an insurer's payments for medical expenses are made to the trust and then treated as a return on that investment. The proposed regulations would clarify that payments from accident or health insurance for medical expenses that are made to the trust (rather than made to the medical service provider or the participant as reimbursement for covered expenses) are treated as having been made to the participant and then contributed by the participant to the plan. Comments are requested on whether there should be limited exceptions to this general rule (such as an exception for a provision that has the effect of a waiver of premium in the case of disability).

The proposed regulations would not alter the incidental benefit rule of §1.401–1(b)(1)(ii) (which provides that a profit-sharing plan may provide incidental life or accident or health insurance for the participant and the participant's family) nor would they alter the tax treatment of the payment of life insurance. For the tax treatment of payments for life insurance, see section 72(m)(3) and §1.72–16.

The general rule that accident and health insurance premiums are taxable distributions would not apply to amounts held under a medical account that satisfies all the requirements of section 401(h). Accident or health insurance purchased through a section 401(h) account does not constitute a taxable distribution. See §1.72–15(h), providing that employer contributions to provide medical benefits in a section 401(h) account under a qualified plan or annuity are not includible in the gross income of the employee on whose behalf contributions were made.[2] The result is the same if the section 401(h) account is funded with a transfer from a qualified pension plan in accordance with section 420. Similarly, section 402(l), as added by PPA '06, permits an exclusion from gross income, up to $3,000 annually, for distributions paid directly to an insurer to purchase accident or health insurance or qualified long-term care insurance for an eligible retired public safety officer and his or her spouse or dependents. The existence of narrow exceptions for retiree medical benefits under section 401(h) and for distributions for the payment of premiums on behalf of eligible retired public safety officers under section 402(l) is consistent with a general rule for inclusion in gross income of the payments of premiums for accident and health insurance.

Section 402(a) provides that amounts actually distributed from a qualified plan are generally taxable to the distributee in the year of the distribution. There is no general exception in section 402 for a distribution in the form of accident or health insurance.[3] Moreover, Congress has carefully prescribed and strictly limited the ability to pre-fund accident and health insurance benefits on a tax-favored basis. The rules specifically prescribed by Congress relating to the pre-funding of future health benefits on a tax-favored basis include the rules in section 223 (providing contribution limits and distribution rules for health savings accounts (HSAs)); sections 419 and 419A (limiting employer deductions for contributions to welfare benefit funds); section 501(c)(9) (providing requirements for tax-exempt Voluntary Employee Beneficiary Associations (VEBAs)); section 512 (providing for the taxation of a VEBA's unrelated business income); and by sections 401(h) and 420 (governing retiree health benefits provided through a separate health benefits account that is part of a pension or annuity plan). Therefore, because Congress specifically prescribed these limited provisions for favorable tax-treatment, a broad exclusion permitting tax-favored treatment of any distribution used to pay accident or health insurance premiums would be inconsistent with this intentional statutory scheme.

In addition, the existence of the incidental benefit rule in §1.401–1(b)(1)(ii) is not

[2] See also H.R. Rep. No. 2317, 87th Cong., 2nd Sess. at 4 (1962), stating that no part of the contributions paid by the employer to a section 401(h) account will be taxed currently to the employee.

[3] See, for example, the Joint Committee on Taxation's Technical Explanation, Technical Explanation of H.R. 4, the "Pension Protection Act of 2006" as passed by the House on July 28, 2006, and Considered by the Senate on August 3, 2006 (JCX–38–06), August 3, 2006, 109th Cong., 2nd Sess. 244 (2006), relating to the exception under section 402(l), which states that, under present law, distributions from a qualified plan are generally included in gross income (subject to exceptions for investment in the contract and qualified distributions from a designated Roth account).

an indication that distributions used to provide incidental life or accident or health insurance benefits are eligible for tax-favorable treatment because the incidental benefit rule relates solely to the qualification of a profit-sharing plan, not to the tax treatment of amounts used to provide medical or accident insurance benefits under such plan.

The proposed regulations also contain conforming amendments to the Income Tax Regulations under sections 72, 105, 106, 401, and 402(c). These conforming amendments would remove obsolete provisions, as well as cite to the rules in these proposed regulations for determining the tax treatment of the payment of premiums for accident and health insurance from a qualified plan. Conforming amendments under sections 403(a) and 403(b) would also add a cross-reference to the regulations under section 403(a) and section 403(b) that would apply the rules in these proposed regulations to those arrangements. In addition, the proposed regulations would revise the first sentence of §1.106–1 in order to update the definition of dependent in light of section 207 of the Working Families Tax Relief Act of 2004, Pub. L. No. 108–311 (118 Stat. 1166) and Notice 2004–79, 2004–2 C.B. 898, see §601.601(d)(2). The proposed regulations would also amend §1.402(c)–2, Q&A–4 to add distributions of premiums for accident or health insurance under §1.402(a)–1(e)(1) to the list of items that are not eligible rollover contributions. Finally, these proposed regulations would also include a cross-reference to section 402(l), as added by PPA '06. For additional guidance on section 402(l), see Notice 2007–7, 2007–5 I.R.B 395, see §601.601(d)(2).

Proposed Effective Date

It is expected that the regulations will apply for calendar years after the publication of final regulations in the **Federal Register**. However, no inference should be drawn that the payment of premiums from a qualified plan does not constitute a taxable distribution if made prior to the effective date of these regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this proposed regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 6, 2007, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by November 19, 2007, and an outline of the topics to be discussed and the amount of time to be devoted to each topic (a signed original and eight (8) copies) by November 15, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Pamela R. Kinard and Michael P. Brewer, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.72–15 is amended by:

1. Revising paragraphs (d), (h), and (i).
2. Removing paragraph (f).

The revisions read as follows:

§1.72–15 Applicability of section 72 to accident or health plans.

* * * * *

(d) *Accident or health benefits attributable to employer contributions.* Any amounts received as accident or health benefits and not attributable to contributions of the employee are includible in gross income except to the extent that such amounts are excludable from gross income under section 105(b) or (c) and the regulations thereunder. See §1.402(a)–1(e) for rules relating to the use of a qualified plan under section 401(a) to pay premiums for accident or health insurance.

* * * * *

(h) *Medical benefits for retired employees, etc.* See §1.402(a)–1(e)(2) for rules relating to the payment of medical benefits described in section 401(h) under a qualified pension or annuity plan.

(i) *Special rules*—(1) *In general.* For purposes of section 72(b) and (d), and this section, the taxpayer shall maintain such records as are necessary to substantiate the

amount treated as an investment in the taxpayer's annuity contract.

(2) *Delegation to Commissioner.* The Commissioner may prescribe a form and instructions with respect to the taxpayer's past and current treatment of amounts received under section 72 or 105, and the taxpayer's computation, or recomputation, of the taxpayer's investment in his or her annuity contract. This form may be required to be filed with the taxpayer's returns for years in which such amounts are excluded under section 72 or 105.

§1.105–4 [Removed]

Par. 3. Section 1.105–4 is removed.

§1.105–6 [Removed]

Par. 4. Section 1.105–6 is removed.

Par. 5. Section 1.106–1 is amended by revising the first sentence and adding a new sentence at the end of the paragraph to read as follows:

§1.106–1 Contributions by employer to accident and health plans.

The gross income of an employee does not include the contributions which the employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse, or the employee's dependents (as defined in section 152 determined without regard to section 152(b)(1), (b)(2), or (d)(1)(B)).

* * *

For the treatment of the payment of premiums for accident or health insurance from a qualified trust under section 401(a), see §§1.72–15 and 1.402(a)–1(e).

Par. 6. Section 1.401–1 is amended by adding a new sentence at the end of paragraph (b)(1)(ii) to read as follows:

§1.401–1 Qualified pension, profit-sharing, and stock bonus plans.

* * * * *

(b) * * * (1)(i) * * *

(ii) * * * See §§1.72–15, 1.72–16, and 1.402(a)–1(e) for rules regarding the tax treatment of incidental life or accident or health insurance.

Par. 7. Section 1.402(a)–1 is amended by removing the last two sentences of paragraph (a)(1)(ii) and adding a new sentence in their place and by adding a new paragraph (e) to read as follows:

§1.402(a)–1 Taxability of beneficiary under a trust which meets the requirements of section 401(a).

(a) * * * (1)(i) * * *

(ii) * * * Paragraph (e) of this section provides rules relating to use of a qualified pension, annuity, profit-sharing, or stock bonus plan to provide accident or health benefits or coverage otherwise described in section 104, 105, or 106.

* * * * *

(e) *Medical, accident, etc., benefits paid from a qualified pension, annuity, profit-sharing, or stock bonus plan*—(1) *Payment of premiums*—(i) *General rule.* The payment of premiums from a qualified trust for accident or health insurance, including a qualified long-term care insurance contract under section 7702B, constitutes a distribution under section 402(a) to the participant against whose benefit the premium is charged. The amount of the distribution equals the amount of the premium charged against the participant's benefits under the plan. If a defined contribution plan pays these premiums from a current year contribution or forfeiture that has not been allocated to a participant's account, then the amount of the premium for each participant will be treated as first being allocated to the participant and then charged against the participant's benefits under the plan, so that the amount of the distribution is treated in the same manner as determined under the preceding sentence. Except as described in paragraphs (e)(2) and (3) of this section, a distribution described in this paragraph (e)(1) is not excludable from gross income.

(ii) *Treatment of amounts received through accident or health insurance.* To the extent that the premium for accident or health insurance constitutes a distribution under this paragraph (e)(1), amounts received through accident or health insurance are neither attributable to contributions by the employer which are not includible in the gross income of the employee nor are such amounts paid by the employer. Accordingly, amounts received through the accident or health insurance for personal injuries or sickness are excludable from gross income under section 104(a)(3) and are not treated as distributions from the plan. If amounts received through accident or health insurance are paid to the plan instead of the employee, these amounts are treated as having been paid to the employee and then contributed by the employee to the plan (and these amounts must satisfy the qualification requirements applicable to employee contributions).

(2) *Medical benefits for retired employees provided under an account described in section 401(h).* The payment of medical benefits described in section 401(h) under a pension or annuity plan is treated in the same manner as a payment of accident or health benefits attributable to employer contributions, or employer-provided coverage under an accident or health plan. See §1.401–14(a) for the definition of medical benefits described in section 401(h). Accordingly, amounts applied for the payment of accident or health benefits, or for the payment of accident or health coverage, from a section 401(h) account are not includible in the gross income of the participant on whose behalf such contributions are made to the extent they are excludible from gross income under section 104, 105, or 106.

(3) *Distributions to eligible retired public safety officers.* See section 402(l) for a limited exclusion from gross income for distributions used to pay for certain accident or health premiums (including premiums for qualified long-term care insurance contracts). This limited exclusion applies to eligible retired public safety officers, as defined in section 402(l)(4)(B).

(4) *Effect of making a distribution of insurance premiums on qualification.* See §1.401–1(b)(1) for rules concerning the types and amount of medical coverage and benefits that are permitted to be provided under a plan that is part of a trust described in section 401(a). For example, §1.401–1(b)(1)(ii) provides that a profit-sharing plan is primarily a plan of deferred compensation, but the amounts allocated to the account of a participant may be used to provide incidental accident or health insurance for the participant and the participant's family. See also, section 401(k)(2)(B) for certain restrictions on the distribution of elective contributions.

(5) *Application of this paragraph (e).* This paragraph (e) applies to the payment of premiums charged against the benefits

of a beneficiary or an alternate payee in the same manner as the payment of premiums charged against the account of a participant.

(6) *Example*. The provisions of this paragraph (e) are illustrated by the following example:

Example. (i) *Facts*. Employer sponsors a profit-sharing plan qualified under section 401(a). The plan provides solely for non-elective employer profit-sharing contributions. The plan's trustee enters into a contract with a third-party insurance carrier to provide health insurance for certain plan participants. The insurance policy provides for the payment of medical expenses incurred by those participants. The plan limits the amounts used to provide medical benefits with respect to a participant to 25 percent of the funds held in the participant's account. The trustee makes monthly payments of $1,000 to pay the premiums due for Participant A's health insurance. The trustee also reduces Participant A's account balance by $1,000 at the time of each premium payment. In June of a year, Participant A is admitted to the hospital for covered medical care, and in July of the same year, the health insurer pays the hospital $5,000 for the medical care provided to Participant A in June.

(ii) *Conclusion*. Under paragraph (e)(1) of this section, each of the trustee's payments of $1,000 constitutes a distribution under section 402(a) to Participant A on the date of each payment. To the extent provided under section 213, the amount of these distributions constitutes payments for medical care. The $5,000 payment to the hospital is excludable from Participant A's gross income under section 104(a)(3) and is not treated as a distribution from the plan.

Par. 8. Section 1.402(c)–2 is amended by redesignating paragraphs A–4(g) and A–4(h) as paragraphs A–4(h) and A–4(i) and adding a new paragraph A–4(g) to read as follows:

§1.402(c)–2 Eligible rollover contributions; questions and answers.

* * * * *

A–4: * * *

(g) Distributions of premiums for accident or health insurance under §1.402(a)–1(e).

* * * * *

Par. 9. Section 1.403(a)–1 is amended by revising paragraph (g) to read as follows:

§1.403(a)–1 Taxability of beneficiary under a qualified annuity plan.

* * * * *

(g) The rules of §1.402(a)–1(e) apply for purposes of determining the treatment of amounts paid to provide accident and health insurance benefits.

Par. 10. Section 1.403(b)–6 is amended by adding a sentence following the first sentence of paragraph (g) to read as follows:

§1.403(b)–6 Timing of distributions and benefits.

* * * * * (g) *Death benefits and other incidental benefits*. * * * The rules of §1.402(a)–1(e) apply for purposes of determining when incidental benefits are treated as distributed and included in gross income. See §§1.72–15 and 1.72–16. * * *

* * * * *

Linda E. Stiff,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 20, 2007, 72 F.R. 46421)

Employer Comparable Contributions to Health Savings Accounts Under Section 4980G; Hearing Cancellation

Announcement 2007–85

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Cancellation of notice of public hearing on proposed rulemaking.

SUMMARY: This document cancels a public hearing on proposed regulations (REG–143797–06, 2007–26 I.R.B. 1495) providing guidance on employer comparable contributions to Health Savings Accounts (HSAs).

DATES: The public hearing, originally scheduled for September 28, 2007 at 10 a.m. is cancelled.

FOR FURTHER INFORMATION CONTACT: Kelly Banks of the Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration) at (202) 622–0392 (not a toll-free number).

SUPPLEMENTARY INFORMATION: A notice of proposed rulemaking and notice of public hearing that appeared in the **Federal Register** on Friday, June 1, 2007 (72 FR 30501), announced that a public hearing was scheduled for September 28, 2007, at 10 a.m. in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. The subject of the public hearing is under section 4980G of the Internal Revenue Code.

The public comment period for these regulations expired on August 30, 2007. The notice of proposed rulemaking and notice of public hearing instructed those interested in testifying at the public hearing to submit a request to speak and an outline of the topics to be addressed by August 28, 2007. As of September 6, 2007, no one has requested to speak and therefore, the public hearing scheduled for September 28, 2007, is cancelled.

LaNita Van Dyke,
Branch Chief,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on September 12, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 13, 2007, 72 F.R. 52319)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–86

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had

knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on September 24, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Museum of American Piano
Bangor, PA
Transitional Living Collaborative
Moraga, CA
Ken-Ray, Incorporated
Orem, UT
DreamHome Foundation
Sherwood, OR
Creativity Innovation
Productivity Incorporated DBA
Horizon Event Foundation
Highwood, MT
Community Fellowship for Battered
Women of Silicon Valley, Inc.
San Jose, CA
Alta Crossing, Inc.
Nampa, ID
Home Buyers Assistance Foundation, Inc.
Denver, CO
International Housing Solutions, Inc.
Sacramento, CA
Filipino American Community
Development Council, Inc.
San Jose, CA

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 805.—General Deductions

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 807.—Rules for Certain Reserves

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 812.—Definition of Company's Share and Policyholders' Share

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 832.—Insurance Company Taxable Income

A revenue procedure to provide a safe harbor under which companies taxable under Subchapter L do not have to include any portion of the increase for the taxable year in policy cash values of life insurance contracts described in section 264(f)(4)(A) ("ICOLI Contracts") for purposes of applying the insurance company proration rules in sections 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5). See Rev. Proc. 2007-61, page 747.

Section 1045.—Rollover of Gain From Qualified Small Business Stock to Another Qualified Small Business Stock

26 CFR 1.1045–1: Application to partnerships.

T.D. 9353

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Section 1045 Application to Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of section 1045 of the Internal Revenue Code (Code) to partnerships and their partners. These regulations provide rules regarding the deferral of gain on a partnership's sale of qualified small business stock (QSB stock) and a partner's sale of QSB stock distributed by a partnership. These regulations also provide rules for a taxpayer (other than a C corporation) who sells QSB stock and purchases replacement QSB stock through a partnership. The regulations affect partnerships that invest in QSB stock and their partners.

DATES: *Effective Date:* These regulations are effective August 14, 2007.

Applicability Dates: For dates of applicability of these regulations, see §1.1045–1(j).

FOR FURTHER INFORMATION CONTACT: Jian H. Grant at (202) 622–3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1893. Responses to these collections of information are mandatory and are required to obtain a benefit. The collections of information in these final regulations are in §1.1045–1(b)(3)(ii)(C), (b)(5)(ii), and (c)(4)(ii). The information collected in §1.1045–1(b)(5)(ii) is required to ensure that gain from the sale of QSB stock by a partnership is reported correctly. The information collected in §1.1045–1(b)(3)(ii)(C) and (c)(4)(ii) will be used by the partnership and the partner to make the basis adjustments upon the sale of QSB stock and the purchase of replacement QSB stock when necessary. The likely respondents are businesses or other for-profit institutions and small businesses or organizations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Estimated total annual reporting burden: 1,500 hours.

The estimated annual burden per respondent varies from 45 to 75 minutes, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 1,500.

Estimated annual frequency of responses: On occasion.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to these collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

Background

This document amends 26 CFR Part 1 under section 1045 of the Code by adding §1.1045–1 regarding the application of section 1045 to partnerships and their partners.

Section 1045 permits a non-corporate taxpayer that holds QSB stock for more than six months and sells it after August 5, 1997, to elect to defer recognizing gain (other than gain treated as ordinary income) on the sale. To qualify for such deferral, the taxpayer must purchase QSB stock (replacement QSB stock) within a 60-day period beginning on the date of the sale of the QSB stock. Any gain not recognized reduces the cost basis of the replacement QSB stock. The taxpayer recognizes gain to the extent the amount realized on the sale of the QSB stock exceeds the cost basis of the replacement QSB stock. The benefits of section 1045 with respect to a sale of QSB stock by a partnership flow through to a non-corporate partner that held an interest in the partnership at all times the partnership held the QSB stock. See section 1045(b)(5) and the legislative history accompanying section 6005(f)(2) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 6005(f)(2)), July 22, 1998. In response to inquiries, the IRS issued Rev. Proc. 98–48, 1998–2 C.B. 367, which provides procedures for taxpayers (including passthrough entities and individuals holding interests in a passthrough entity) to elect to apply section 1045. Since Rev. Proc. 98–48 was published, the IRS and the Treasury Department received further inquiries regarding the application of section 1045 to partnerships and their partners. See §601.601(d)(2)(ii)(*b*) of this chapter.

On July 15, 2004, in response to those inquiries, a notice of proposed rulemaking and a notice of public hearing (REG–150562–03, 2004–2 C.B. 175) were published in the **Federal Register** (69 FR 42370) regarding the application of section 1045 to partnerships and their partners. No one requested to speak at the public hearing. Accordingly, the public hearing scheduled for November 9, 2004, was cancelled in the **Federal Register** (69 FR 62631) on October 27, 2004. Comments responding to the proposed regulations were received. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Explanation of Revisions

1. *QSB Stock — Replacement QSB Stock Requirement*

The proposed regulations provided that the term "QSB stock" had the same meaning given such term by section 1202(c) and did not include an interest in a partnership that held QSB stock. Thus, under the proposed regulations, an investment in a partnership that held QSB stock was not treated as an investment in QSB stock. Consequently, a partner that sold an interest in a partnership that held QSB stock was not treated as selling QSB stock, and could not elect to apply section 1045 with respect to gain realized on the sale of the partnership interest. Similarly, under the proposed regulations, a partner that made a section 1045 election with respect to QSB stock sold by the partnership could not treat as replacement QSB stock an interest in a second partnership that held QSB stock.

Commentators agreed that an interest in a partnership that owns QSB stock should not be treated as an investment in QSB stock. Some commentators, however, argued that the final regulations should permit a partner that makes a section 1045 election with respect to QSB stock sold by one partnership to satisfy the replacement QSB stock requirement of section 1045 by holding an interest in a partnership, which acquires QSB stock within the statutory period. Commentators believed that the suggested rule is consistent with the intent of Congress to encourage investments in QSB stock.

The final regulations adopt this comment. A taxpayer (other than a C corporation) that sells QSB stock and elects to apply section 1045 may satisfy the replacement QSB stock requirement with QSB stock that is purchased within the statutory period by a partnership in which the taxpayer is a partner on the date the QSB stock is purchased (purchasing partnership). In addition, the final regulations provide that an eligible partner of a partnership that sells QSB stock (selling partnership) and elects to apply section 1045 may satisfy the replacement QSB stock requirement with QSB stock purchased by a purchasing partnership during the statutory period. The IRS and the Treasury Department believe that these rules are appropriate because they are consistent with the underlying continuous economic interest requirement of section 1045. Although the final regulations permit the replacement QSB stock requirement to be satisfied in this manner, for the reasons stated, a partner that sells its interest in the purchasing partnership is not treated as selling replacement QSB stock.

The final regulations contain rules for calculating a partner's distributive share of partnership gain that is not recognized as a result of an election under section 1045 by the partner. These rules are necessary for determining how much gain a partner can defer upon a sale of QSB stock under section 1045. These rules address instances in which the eligible partner continues to defer gain under section 1045 from a prior sale or sales of QSB stock.

2. *Basis Adjustments*

The proposed regulations provided rules regarding adjustments to an eligible partner's basis in a partnership interest and a partnership's basis in replacement QSB stock. One rule required a partnership to make a basis adjustment to the partnership's replacement QSB stock by the amount of gain from the partnership's sale of QSB stock that is deferred by an eligible partner, the effect of which is determined under the principles of §1.743–1(g), (h), and (j). Under this rule, the basis adjustments constitute an adjustment to the basis of the partnership's replacement QSB stock with respect to that eligible partner only. To allow the partnership to make the appropriate basis adjustments, the proposed regulations required any partner that must recognize all or a part of the partner's distributive share of partnership section 1045 gain to notify the partnership of the amount of the partnership section 1045 gain that was recognized.

One commentator argued that many partnerships that invest in QSB stock are thinly staffed, and that they would incur additional administrative expenses to comply with the notification and basis adjustment requirements. Therefore, the commentator suggested that the partner

make the basis adjustments with respect to the partnership's replacement QSB stock, unless the partnership makes an election to make the basis adjustments.

The IRS and the Treasury Department believe that, if the partnership makes an election under section 1045 and purchases replacement QSB stock, the partnership is the proper party to make the appropriate basis adjustments with respect to that stock. Accordingly, this comment is not adopted. As noted below, a partnership is not required to maintain these basis adjustments for eligible partners that separately make the election under section 1045. The final regulations also clarify that if a partnership makes an election under section 1045, the partnership must attach a statement to the partnership return for the taxable year in which the partnership purchases replacement QSB stock setting forth the computation of the adjustment, the replacement QSB stock to which the adjustment has been made, the date(s) on which such stock was acquired by the partnership, and each partner's distributive share of deferred partnership section 1045 gain.

If a taxpayer or an eligible partner makes an election under section 1045 and treats its interest in QSB stock purchased by a purchasing partnership as its replacement QSB stock, the final regulations provide specific rules for the determination of the partner's basis in the replacement QSB stock and interest in the purchasing partnership. In these cases, the partner's adjusted basis in the partnership interest is reduced by the partner's gain that is deferred under section 1045, and the electing partner must reduce its share of the partnership's adjusted basis of the replacement QSB stock by the amount of gain deferred. When the basis reduction results from a partner-level election, the final regulations require the partner, rather than the partnership, to retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment has been made, and the date(s) on which such stock was acquired by the purchasing partnership.

3. *Gain Recognition Upon Certain Distributions*

The final regulations provide rules requiring a partner to recognize gain upon a distribution of replacement QSB stock to another partner that reduces the partner's share of the replacement QSB stock held by a partnership. The amount of gain that the partner must recognize is determined based on the amount of gain that the partner would have recognized upon a sale of the distributed replacement QSB stock for its fair market value on the date of the distribution (not to exceed the amount of gain previously deferred by the partner with respect to the distributed replacement QSB stock). Any gain recognized by a partner whose interest is reduced must be taken into account in determining the adjusted basis of the partner's interest in the partnership and also taken into account in determining the partnership's adjusted basis in the QSB stock distributed to another partner under §1.1045–1(e)(4). These rules apply in the case of a partner election or a partnership election under section 1045.

4. *Nonrecognition Limitation*

The proposed regulations provided that the amount of gain that an eligible partner may defer under section 1045 may not exceed: (A) the partner's smallest percentage interest in the partnership's income, gain, or loss with respect to the QSB stock that was sold, multiplied by (B) the partnership's realized gain from the sale of such stock. This nonrecognition rule follows section 1202(g)(2) and (3) by ensuring that the partner can defer recognition of only the gain that relates to the partner's continuous economic interest in the QSB stock that was sold.

Commentators agreed with the underlying "continuous ownership" requirement in the proposed regulations, but raised concerns that the nonrecognition limitation rule may be difficult to administer when a partnership does not have a simple "*pro rata*" partnership arrangement. One commentator suggested that the nonrecognition limitation rule only apply in certain situations.

The IRS and the Treasury Department continue to believe that a nonrecognition limitation rule is consistent with section 1045 and the underlying continuous economic interest requirement in section 1202(g)(2) and (3). The continuous economic interest requirement as applied under section 1202(c)(1)(B) requires that QSB stock must be acquired by the taxpayer at its original issuance in exchange for money or other property or as compensation for services provided to such corporation. Taxpayers that invest through a partnership acquire the requisite interest for purposes of the continuous economic interest requirement by an investment of capital in the partnership. Accordingly, to address the commentator's concerns, the nonrecognition rule has been modified to provide that the amount of gain that an eligible partner may defer under section 1045 may not exceed: (A) the partner's smallest percentage interest in partnership capital from the time the QSB stock is acquired until the time the QSB stock is sold, multiplied by (B) the partnership's realized gain from the sale of such stock. The IRS and the Treasury Department believe that this nonrecognition rule in the final regulations will be easier to administer, is consistent with each partner's economic interest in the partnership, and will not inappropriately limit the amount of gain that can be deferred.

5. *Opt Out of Partnership Election by Partner*

The proposed regulations allowed an eligible partner to make a section 1045 election with respect to all or part of the partner's share of gain from the partnership's sale of QSB stock only if the partnership did not make a section 1045 election, or the partnership did make a section 1045 election, but failed to purchase any (or enough) replacement QSB stock within the statutory time period. If a partnership elected to apply section 1045 and purchased replacement QSB stock, all eligible partners of the partnership were required to defer their distributive shares of the partnership section 1045 gain. One commentator suggested that an eligible partner should be allowed to opt out of a partnership section 1045 election and either purchase separate replacement QSB stock directly, and elect to apply section 1045 at the partner level, or recognize the partner's distributive share of the partnership section 1045 gain. The IRS and the Treasury Department believe that allowing a partner to opt out of a partnership section 1045 election is consistent with providing the intended and desired flexibility for investments in QSB stock. Accordingly, this comment is

adopted. The final regulations provide that a partner that elects out of a partnership's section 1045 election must notify the partnership in writing. If an eligible partner opts out of a partnership section 1045 election, such action does not constitute a revocation of the partnership section 1045 election and the partnership section 1045 election continues to apply to the other partners.

The final regulations do not impose a deadline for when a partner must notify the partnership that the partner is opting out of a partnership section 1045 election. The IRS and the Treasury Department believe partnerships are responsible for obtaining the required information to report gain properly, and that the partnership agreement should require that partners supply this notice to the partnership in a timely manner.

6. *Tiered-partnership Rules*

Under the proposed regulations, only an eligible partner was entitled to defer gain under section 1045. The proposed regulations provided special rules for determining whether a partner was an eligible partner if a partnership (upper-tier partnership) held an interest in a partnership (lower-tier partnership) that held QSB stock. The proposed regulations disregarded the upper-tier partnership's ownership of the lower-tier partnership and treated each partner of the upper-tier partnership as owning an interest in the lower-tier partnership directly. The preamble to the proposed regulations explained that, although this rule provided a simple approach, it limited the availability of section 1045 in situations involving tiered partnerships. The IRS and the Treasury Department requested comments specifically on the application of section 1045 in tiered-partnership situations.

Commentators suggested that an upper-tier partnership should be an "eligible partner" of a lower-tier partnership and allowed to make an election to defer gain under section 1045 with respect to the distributive share of the gain from the lower-tier partnership's sale of QSB stock. After careful consideration, the IRS and the Treasury Department have concluded that treating an upper-tier partnership as an "eligible partner" of a lower-tier partnership would create an unacceptable administrative burden and increased complexity to the rules. Therefore, the final regulations retain the rule in the proposed regulations relating to tiered-partnership structures. The final regulations, however, clarify that the rule does not preclude a partner in an upper-tier partnership from treating its interest in QSB stock that was purchased by either the upper-tier partnership or a lower-tier partnership as replacement QSB stock. The final regulations contain an example illustrating this rule.

7. *Disregarded Entity Rules*

One commentator suggested that the final regulations set forth rules that are specific to disregarded entities. It has been determined that this suggestion is beyond the scope of the regulations and, therefore, is not included in the final regulations.

8. *Election Procedures and Reporting Rules*

The proposed regulations provided that a partnership making a section 1045 election must do so on the partnership's timely filed return (including extensions) for the taxable year during which the partnership sells the QSB stock. The proposed regulations also provided that a partner making an election under section 1045 with respect to its distributive share of gain on the partnership's sale of QSB stock must do so on the partner's timely filed Federal income tax return (including extensions) for the taxable year in which such gain is taken into account. The final regulations retain these rules. However, in both cases, the proposed regulations stated that the electing partnership or partner also must follow the procedures of Rev. Proc. 98–48. In contrast, the final regulations provide that a partnership making an election under section 1045 or a partner making an election under section 1045 must do so in accordance with the applicable forms and instructions. It is anticipated that the applicable forms and instructions will be revised to take into account the rules in the final regulations.

Effective/Applicability Date

The final regulations apply to sales of QSB stock on or after August 14, 2007.

Effect on Other Documents

Rev. Proc. 98–48, 1998–2 C.B. 367, is modified to include the following sentence at the end of the PURPOSE section: "This revenue procedure does not apply in situations described in §1.1045–1 of the Income Tax regulations." See §601.601(d)(2)(ii)(*b*) of this chapter.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that QSB stock is not held by a substantial number of small entities and that the time required to make the election is estimated to average 1 hour. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jian H. Grant, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1045–1 is added to read as follows:

§1.1045–1 Application to partnerships.

(a) *Overview of section.* A partnership that holds qualified small business stock (QSB stock) (as defined in paragraph (g)(1) of this section) for more than 6 months, sells such QSB stock, and purchases replacement QSB stock (as defined in paragraph (g)(2) of this section) may elect to apply section 1045. An eligible partner (as defined in paragraph (g)(3) of this section) of a partnership that sells QSB stock, may elect to apply section 1045 if the eligible partner purchases replacement QSB stock directly or through a purchasing partnership (as defined in paragraph (c)(1)(i) of this section). A taxpayer (other than a C corporation) that holds QSB stock for more than 6 months, sells such QSB stock and purchases replacement QSB stock through a purchasing partnership may elect to apply section 1045. A section 1045 election is revocable only with the prior written consent of the Commissioner. To obtain the Commissioner's prior written consent, the person who made the section 1045 election must submit a request for a private letter ruling. (For further guidance, see Rev. Proc. 2007–1, 2007–1 C.B. 1 (or any applicable successor) and §601.601(d)(2)(ii)(*b*) of this chapter.) Paragraph (b) of this section provides rules for partnerships that elect to apply section 1045. Paragraph (c) of this section provides rules for certain taxpayers other than C corporations and for eligible partners that elect to apply section 1045. Paragraph (d) of this section provides a limitation on the amount of gain that an eligible partner does not recognize under section 1045. Paragraph (e) of this section provides rules for partnership distributions of QSB stock to an eligible partner. Paragraph (f) of this section provides rules for contributions of QSB stock or replacement QSB stock to a partnership. Paragraph (g) of this section provides definitions of certain terms used in section 1045 and this section. Paragraph (h) of this section provides reporting rules for partnerships and partners that elect to apply section 1045. Paragraph (i) of this section provides examples illustrating the provisions of this section. Paragraph (j) of this section contains the effective date.

(b) *Partnership election*—(1) *Partnership purchase of replacement QSB stock.* A partnership that holds QSB stock for more than 6 months, sells such QSB stock, and purchases replacement QSB stock may elect in accordance with paragraph (h) of this section to apply section 1045. If the partnership elects to apply section 1045, then, subject to the provisions of paragraphs (b)(4) and (d) of this section, each eligible partner shall not recognize its distributive share of any partnership section 1045 gain (as determined under paragraph (b)(2) of this section). For this purpose, partnership section 1045 gain equals the partnership's gain from the sale of the QSB stock reduced by the greater of—

(i) The amount of the gain from the sale of the QSB stock that is treated as ordinary income; or

(ii) The excess of the amount realized by the partnership on the sale over the total cost of all replacement QSB stock purchased by the partnership (excluding the cost of any replacement QSB stock purchased by the partnership that is otherwise taken into account under section 1045).

(2) *Partner's distributive share of partnership section 1045 gain.* A partner's distributive share of partnership section 1045 gain shall be in the same proportion as the partner's distributive share of the partnership's gain from the sale of the QSB stock. For this purpose, the partnership's gain from the sale of QSB stock and the partner's distributive share of that gain are determined without regard to basis adjustments under section 743(b) and paragraph (b)(3)(ii) of this section.

(3) *Basis adjustments*—(i) *Partner's interest in a partnership.* The adjusted basis of an eligible partner's interest in a partnership shall not be increased under section 705(a)(1) by gain from a partnership's sale of QSB stock that is not recognized by the partner as the result of a partnership election under paragraph (b)(1) of this section.

(ii) *Partnership's replacement QSB stock*—(A) *Rule.* The basis of a partnership's replacement QSB stock is reduced (in the order acquired) by the amount of gain from the partnership's sale of QSB stock that is not recognized by an eligible partner as a result of the partnership's election under section 1045. The basis adjustment with respect to any amount described in this paragraph (b)(3)(ii) constitutes an adjustment to the basis of the partnership's replacement QSB stock with respect to that partner only. The effect of such a basis adjustment is determined under the principles of §1.743–1(g), (h), and (j) except as modified in this paragraph (b)(3)(ii)(A). If a partnership sells QSB stock with respect to which a basis adjustment has been made under this paragraph (b)(3)(ii), and the partnership makes an election under paragraph (b)(1) of this section with respect to the sale and purchases replacement QSB stock, the basis adjustment shall carry over to the replacement QSB stock except to the extent otherwise provided in this paragraph (b)(3)(ii). The basis adjustment that carries over to the replacement QSB stock shall be reduced (but not below zero) by the eligible partner's distributive share of the excess, if any, of the greater of the amount determined under paragraph (b)(1)(i) or (ii) of this section from the sale of the QSB stock, over the partnership's gain from the sale of the QSB stock (determined without regard to basis adjustments under section 743 or paragraph (b)(3)(ii) of this section). The excess amount that reduces the basis adjustment shall be accounted for as gain in accordance with §1.743–1(j)(3). See *Example 5* of paragraph (i) of this section. For purposes of this paragraph (b)(3)(ii), a partnership must presume that a partner did not recognize that partner's distributive share of the partnership section 1045 gain as a result of the partnership's section 1045 election unless the partner notifies the partnership to the contrary as described in paragraph (b)(5)(ii) of this section. However, if a partnership knows that a particular partner is classified, for Federal tax purposes, as a C corporation, then the partnership may presume that the partner did not defer recognition of its distributive share of the partnership section 1045 gain, even in the absence of a notification by the partner. If a partnership makes an election under section 1045, but an eligible partner opts out of the election under paragraph (b)(4) of this section and provides to the partnership the notification required under paragraph (b)(5)(ii) of this section, no basis adjustments under this paragraph (b)(3)(ii) are required with respect to that partner as a result of the section 1045 election by the partnership.

(B) *Tiered-partnership rule.* If a partnership (upper-tier partnership) holds an interest in another partnership (lower-tier partnership) that makes an election under

section 1045, the portion of the lower-tier partnership's basis adjustment as provided in paragraph (b)(3)(ii)(A) of this section in the replacement QSB stock must be segregated and allocated to the upper-tier partnership and any eligible partner as defined in paragraph (g)(3)(iii) of this section. Similarly, that portion of the basis of the upper-tier partnership's interest in the lower-tier partnership attributable to the basis adjustment as provided in paragraph (b)(3)(ii)(A) of this section in the lower-tier partnership's replacement QSB stock must be segregated and allocated solely to any eligible partner as defined in paragraph (g)(2)(iii) of this section.

(C) *Statement of adjustments.* A partnership that must adjust the basis of replacement QSB stock under this paragraph (b) must attach a statement to the partnership return for the taxable year in which the partnership purchases replacement QSB stock setting forth the computation of the adjustment, the replacement QSB stock to which the adjustment has been made, the date(s) on which such QSB stock was acquired by the partnership, and the amount of the adjustment that is allocated to each partner.

(4) *Eligible partners may opt out of partnership's section 1045 election.* An eligible partner may opt out of the partnership's section 1045 election with respect to QSB stock either by recognizing the partner's distributive share of the partnership section 1045 gain, or by making a partner section 1045 election under paragraph (c) of this section with respect to the partner's distributive share of the partnership section 1045 gain. See paragraph (b)(5)(ii) of this section for applicable notification requirements. Opting out of a partnership's section 1045 election under this paragraph (b)(4) does not constitute a revocation of the partnership's election, and such election shall continue to apply to other partners of the partnership.

(5) *Notice requirements*—(i) *Partnership notification to partners.* A partnership that makes an election under paragraph (b)(1) of this section must notify all of its partners of the election and the purchase of replacement QSB stock, in accordance with the applicable forms and instructions, and separately state each partner's distributive share of partnership section 1045 gain from the sale of QSB stock under section 702. Each partner shall determine whether the partner is an eligible partner within the meaning of paragraph (g)(3) of this section and report the partner's distributive share of partnership section 1045 gain from the partnership's sale of QSB stock, including gain not recognized, in accordance with the applicable forms and instructions.

(ii) *Partner notification to partnership.* Any partner that must recognize all or part of the partner's distributive share of partnership section 1045 gain must notify the partnership, in writing, of the amount of partnership section 1045 gain that is recognized by the partner. Similarly, an eligible partner that opts out of a partnership's section 1045 election under paragraph (b)(4) of this section must notify the partnership, in writing, that the partner is opting out of the partnership's section 1045 election.

(c) *Partner election*—(1) *In general*—(i) *Rule.* An eligible partner of a partnership that sells QSB stock (selling partnership) may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by the eligible partner. An eligible partner of a selling partnership may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by a partnership in which the taxpayer is a partner (directly or through an upper-tier partnership) on the date on which the partnership acquires the replacement QSB stock (purchasing partnership). A taxpayer other that a C corporation that sells QSB stock held for more than 6 months at the time of the sale may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by a purchasing partnership (including a selling partnership).

(ii) *Partner purchase of replacement QSB stock.* Subject to paragraph (d) of this section, an eligible partner of a selling partnership that elects to apply section 1045 with respect to the eligible partner's purchase of replacement QSB stock must recognize its distributive share of gain from the sale of QSB stock by the selling partnership only to the extent of the greater of—

(A) The amount of the eligible partner's distributive share of the selling partnership's gain from the sale of the QSB stock that is treated as ordinary income; or

(B) The excess of the eligible partner's share of the selling partnership's amount realized (as determined under paragraph (c)(2) of this section) on the sale by the selling partnership of the QSB stock (excluding the cost of any replacement QSB stock purchased by the selling partnership) over the cost of any replacement QSB stock purchased by the eligible partner (excluding the cost of any replacement QSB stock that is otherwise taken into account under section 1045).

(iii) *Partnership purchase of replacement QSB stock*—(A) *Partner of a selling partnership.* Subject to paragraph (d) of this section, an eligible partner that treats its interest in QSB stock purchased by a purchasing partnership as a purchase of replacement QSB stock by the eligible partner and that elects to apply section 1045 with respect to such purchase must recognize its total gain (the eligible partner's distributive share of gain from the selling partnership's sale of QSB stock and any gain taken into account under paragraph (c)(5) of this section from the sale of replacement QSB stock) only to the extent of the greater of—

(*1*) The amount of the eligible partner's distributive share of the selling partnership's gain from the sale of the QSB stock that is treated as ordinary income; or

(*2*) The excess of the eligible partner's share of the selling partnership's amount realized (as determined under paragraph (c)(2) of this section) on the sale by the selling partnership of the QSB stock (excluding the cost of any replacement QSB stock purchased by the selling partnership) over the eligible partner's share of the purchasing partnership's cost of the replacement QSB stock, as determined under paragraph (c)(3) of this section (excluding the cost of any QSB stock that is otherwise taken into account under section 1045).

(B) *Taxpayer other than a C corporation.* Subject to paragraph (d) of this section, a taxpayer other than a C corporation that treats its interest in QSB stock purchased by a purchasing partnership with respect to which the taxpayer is a partner as a purchase of replacement QSB stock by the taxpayer must recognize its gain from the sale of the QSB stock only to the extent of the greater of—

(*1*) The amount of gain from the sale of the QSB stock that is treated as ordinary income; or

(*2*) The excess of the amount realized by the taxpayer on the sale of the QSB stock over the partner's share of the purchasing partnership's cost of the replacement QSB stock, as determined under paragraph (c)(3) of this section (excluding the cost of any QSB stock that is otherwise taken into account under section 1045).

(2) *Eligible partner's share of amount realized by partnership*—(i)—*General rule*. The eligible partner's share of the amount realized by the selling partnership is the amount realized by the partnership on the sale of the QSB stock (excluding the cost of any replacement QSB stock otherwise taken into account under section 1045) multiplied by the following fraction—

(A) The numerator of which is the eligible partner's distributive share of the partnership's realized gain from the sale of the QSB stock; and

(B) The denominator of which is the partnership's realized gain on the sale of the QSB stock.

(ii) *General rule modified for determining eligible partner's share of amount realized by purchasing partnership upon a sale of replacement QSB stock in certain situations*—(A) *No gain realized or loss realized on sale of replacement QSB stock*. If a purchasing partnership does not realize a gain or realizes a loss from the sale of replacement QSB stock for which an election under this section was made for purposes of applying paragraph (c)(1)(iii)(A) of this section, the eligible partner's share of the amount realized is—

(*1*) The greater of—

(*i*) The amount determined in paragraph (c)(2)(i) of this section from a prior sale of QSB stock (that is not otherwise taken into account under paragraph (c)(2) of this section) in which the eligible partner had a distributive share of gain allocated to the eligible partner that was not recognized under paragraph (c)(1)(iii)(A) of this section; or

(*ii*) The amount realized by a taxpayer other than a C corporation from a prior sale of QSB stock (that is not otherwise taken into account under paragraph (c)(2) of this section) in which the taxpayer realized gain that was not recognized under paragraph (c)(1)(iii)(B) of this section; less

(*2*) The eligible partner's distributive share of any loss recognized on the sale of replacement QSB stock, if applicable.

(B) *Eligible partner's interest in purchasing partnership is reduced and gain realized on sale of replacement QSB stock*. If an eligible partner's interest in a purchasing partnership is reduced subsequent to the sale of QSB stock and the purchasing partnership realizes a gain from the sale of the replacement QSB stock, the eligible partner's share of the amount realized upon a sale of replacement QSB stock must be determined under paragraph (c)(2)(i) of this section based on the distributive share of the partnership's realized gain that would have been allocated to the eligible partner if the eligible partner's interest in the partnership had not been reduced.

(iii) *Eligible partner's share of the amount realized*. For purposes of determining the eligible partner's share of the amount realized by the partnership, the partnership's realized gain from the sale of QSB stock and the eligible partner's distributive share of that gain are determined without regard to basis adjustments under section 743(b) and paragraphs (b)(3)(ii) and (c) of this section.

(3) *Partner's share of the cost of QSB stock purchased by a purchasing partnership*. The partner's share of the cost (adjusted basis) of replacement QSB stock purchased by a purchasing partnership is the percentage of the partnership's future income and gain, if any, that is reasonably expected to be allocated to the partner (determined without regard to any adjustment under section 1045) with respect to the replacement QSB stock that was purchased by the partnership, multiplied by the cost of that replacement QSB stock. The assumptions made by a partnership in determining the reasonably expected allocation of income and gain must be consistent for each partner. For example, a partnership may not treat the same item of income or gain as being reasonably expected to be allocated to more than one partner.

(4) *Basis adjustments*—(i) *Eligible partner's interest in selling partnership*. Under section 705(a)(1), the adjusted basis of an eligible partner's interest in a selling partnership that sells QSB stock is increased by the partner's distributive share of gain without regard to paragraph (c)(1) of this section. However, if the selling partnership is also a purchasing partnership, the adjusted basis of an eligible partner's interest in a partnership that sells QSB stock may be reduced under paragraph (c)(4)(iii) of this section.

(ii) *Replacement QSB stock*. A partner's basis in any replacement QSB stock that is purchased by the partner, as well as the adjusted basis of any replacement QSB stock that is purchased by a purchasing partnership and that is treated as the partner's replacement QSB stock must be reduced (in the order replacement QSB stock is acquired by the partner and purchasing partnership, as applicable) by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner under paragraph (c)(1) of this section, or by the gain on a sale of QSB stock by the partner that is not recognized by the partner under section 1045, as applicable. If replacement QSB stock is purchased by the purchasing partnership, the purchasing partnership shall maintain its adjusted basis in the replacement QSB stock without regard to any basis adjustments required by this paragraph (c)(4)(ii). The eligible partner, however, shall in computing its distributive share of income, gain, loss and deduction from the purchasing partnership with respect to the replacement QSB stock take into account the variation between the adjusted basis in the QSB stock as determined under this paragraph (c)(4)(ii) and the adjusted basis determined without regard to this paragraph (c)(4)(ii). A partner must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment has been made, and the date(s) on which such stock was acquired. See *Examples 7* and *8* of paragraph (i) of this section.

(iii) *Partner's basis in purchasing partnership interest*. A partner that treats the partner's interest in QSB stock purchased by a purchasing partnership as the partner's replacement QSB stock must reduce (in the order replacement QSB stock is acquired) the adjusted basis of the partner's interest in the purchasing partnership by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner pursuant to paragraph (c)(1) of this section, or by the gain on a sale of QSB stock

by the partner that is not recognized by the partner under section 1045, as applicable. Similarly, a partner of an upper-tier partnership that treats the partner's interest in QSB stock purchased by a lower-tier purchasing partnership as the partner's replacement QSB stock must reduce (in the order replacement QSB stock is acquired) the adjusted basis of the partner's interest in the upper-tier partnership by the partner's distributive share of the gain on the sale of the selling partnership's QSB stock that is not recognized by the partner pursuant to paragraph (c)(1) of this section, or by the gain on a sale of QSB stock by the partner that is not recognized by the partner under section 1045, as applicable.

(iv) *Increase in basis on sale of QSB stock by purchasing partnership.* A partner that recognizes gain under paragraph (c)(5) of this section must increase the adjusted basis of the partner's interest in the purchasing partnership under section 705(a)(1) by the amount of the gain recognized by that partner. Similarly, a partner in an upper-tier partnership that recognizes gain under paragraph (c)(5) of this section must increase the adjusted basis of the partner's interest in the upper-tier partnership under section 705(a)(1) by the amount of the gain recognized by that partner.

(5) *Partner recognition of gain.* At the time that either the partner or the purchasing partnership (whichever applies) sells or exchanges replacement QSB stock, the amount recognized by the partner is determined by taking into account the basis adjustments described in paragraph (c)(4)(ii) of this section. Similarly, a partner of an upper-tier partnership that owns an interest in a lower-tier partnership that holds replacement QSB stock must take into account the basis adjustments described in paragraph (c)(4)(ii) of this section in determining the amount recognized by the partner on a sale of the interest in the lower-tier partnership by the upper-tier partnership or the partner's distributive share of gain from the upper-tier partnership. See paragraph (e)(4) of this section for rules applicable to certain distributions of replacement QSB stock.

(d) *Nonrecognition limitation*—(1) *In general.* For purposes of this section, the amount of gain that an eligible partner does not recognize under paragraphs (b)(1) and (c)(1) of this section cannot exceed the nonrecognition limitation. Except as otherwise provided in paragraph (d)(2) of this section, the nonrecognition limitation is equal to the product of—

(i) The partnership's realized gain from the sale of the QSB stock, determined without regard to any basis adjustment under section 734(b) or section 743(b) (other than basis adjustments described in paragraph (b)(3)(ii) of this section); and

(ii) The eligible partner's smallest percentage interest in partnership capital as determined in paragraph (d)(2) of this section. See *Example 9* of paragraph (i) of this section.

(2) *Eligible partner's smallest percentage interest in partnership capital.* An eligible partner's smallest percentage interest in partnership capital is the eligible partner's percentage share of capital determined at the time of the acquisition of the QSB stock as adjusted prior to the time the QSB stock is sold to reflect any reduction in the capital of the eligible partner including a reduction as a result of a disproportionate capital contribution by other partners, a disproportionate capital distribution to the eligible partner or the transfer of an interest by the eligible partner, but excluding income and loss allocations.

(3) *Special rule for tiered partnerships.* For purposes of paragraph (d)(1)(ii) of this section, if an eligible partner is treated as owning an interest in a lower-tier purchasing partnership through an upper-tier partnership, the eligible partner's percentage interest in the purchasing partnership shall be proportionately adjusted to reflect the eligible partner's percentage interest in the upper-tier partnership.

(e) *Partnership distribution of QSB stock to a partner*—(1) *In general.* Subject to paragraphs (e)(2) and (3) of this section, in the case of a partnership distribution of QSB stock to a partner, the partner shall be treated for purposes of this section as—

(i) Having acquired such stock in the same manner as the partnership; and

(ii) Having held such stock during any continuous period immediately preceding the distribution during which it was held by the partnership. See *Examples 10* and *11* of paragraph (i) of this section.

(2) *Eligibility under section 1202(c).* Paragraph (e)(1) of this section does not apply unless all eligibility requirements with respect to QSB stock as defined in section 1202(c) are met by the distributing partnership with respect to its investment in QSB stock.

(3) *Distribution nonrecognition limitation*—(i) *Generally.* The amount of gain that an eligible partner does not recognize under this section on the sale of QSB stock that was distributed by the partnership to the partner cannot exceed the distribution nonrecognition limitation. For this purpose, the distribution nonrecognition limitation is—

(A) The partner's section 1045 amount realized (determined under paragraph (e)(3)(ii) of this section); reduced by

(B) The partner's section 1045 adjusted basis (determined under paragraph (e)(3)(iii) of this section).

(ii) *Section 1045 amount realized*—(A) *QSB stock received in liquidation of partner's interest and in certain nonliquidating distributions.* If a partner receives QSB stock from the partnership in a distribution in liquidation of the partner's interest in the partnership or as part of a series of related distributions by the partnership in which the partnership distributes all of the partnership's QSB stock of a particular type, then the partner's section 1045 amount realized is the partner's amount realized from the sale of the distributed QSB stock, multiplied by a fraction—

(*1*) The numerator of which is the partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section; and

(*2*) The denominator of which is the partner's percentage interest in that type of QSB stock immediately after the distribution (determined under paragraph (e)(3)(iv) of this section).

(B) *Partner's smallest percentage interest in partnership capital.* A partner's smallest percentage interest in partnership capital is the partner's percentage share of capital determined at the time of the acquisition of the QSB stock as adjusted prior to the time the QSB stock is distributed to the partner to reflect any reduction in the capital of the partner including a reduction as a result of a disproportionate capital contribution by other partners, a disproportionate capital distribution to the partner, or the transfer of a capital interest by the partner, but excluding income and loss allocations.

(C) *QSB stock received in other distributions.* If a partner receives QSB stock in a distribution from the partnership that is not described in paragraph (e)(3)(ii)(A)

of this section, the partner's section 1045 amount realized is the partner's amount realized from the sale of the distributed QSB stock multiplied by the partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section.

(iii) *Section 1045 adjusted basis*—(A) *QSB stock received in liquidation of partner's interest and in certain nonliquidating distributions.* If a partner receives QSB stock from the partnership in a distribution in liquidation of the partner's interest in the partnership or as part of a series of related distributions by the partnership in which the partnership distributes all of the partnership's QSB stock of a particular type, then the partner's section 1045 adjusted basis is the product of—

(*1*) The partnership's basis in all of the QSB stock of the type distributed (without regard to basis adjustments under section 734(b) or section 743(b), other than basis adjustments described in paragraphs (b)(3)(ii) and (c)(4)(ii) of this section);

(*2*) The partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section; and

(*3*) The proportion of the distributed QSB stock that was sold by the partner.

(B) *QSB stock received in other distributions.* If a partner receives QSB stock in a distribution from the partnership that is not described in paragraph (e)(3)(iii)(A) of this section, the partner's section 1045 adjusted basis is the product of—

(*1*) The partnership's basis in the QSB stock sold by the partner (without regard to basis adjustments under section 734(b) or section 743(b), other than basis adjustments described in paragraphs (b)(3)(ii) and (c)(4)(ii) of this section); and

(*2*) The partner's smallest percentage interest in partnership capital determined under paragraph (e)(3)(ii)(B) of this section.

(iv) *Partner's percentage interest in distributed QSB stock.* For purposes of this paragraph (e)(3), a partner's percentage interest in a type of QSB stock immediately after a partnership distribution is the value (as of the date of the distribution) of the QSB stock distributed to the partner divided by the value (as of the date of the distribution) of all of that type of QSB stock that was acquired by the partnership.

(v) *QSB stock of the same type.* For purposes of this paragraph (e)(3), QSB stock will be of the same type as the distributed QSB stock if it has the same issuer and the same rights and preferences as the distributed QSB stock and was acquired by the partnership at original issue.

(4) *Distribution of replacement QSB stock to a partner that reduces another partner's interest in the replacement QSB stock.* For purposes of this section, a partner must recognize gain upon a distribution of replacement QSB stock to another partner that reduces the partner's share of the replacement QSB stock held by a partnership. The amount of gain that the partner must recognize is determined based on the amount of gain that the partner would recognize upon a sale of the distributed replacement QSB stock for its fair market value on the date of the distribution but not to exceed the amount that was previously not recognized by the partner under section 1045 with respect to the distributed replacement QSB stock. Any gain recognized by a partner whose interest is reduced must be taken into account in determining the adjusted basis of the partner's interest in the partnership and also taken into account in determining the partnership's adjusted basis in the QSB stock distributed to another partner under paragraph (e)(3) of this section.

(f) *Contribution of QSB stock or replacement QSB stock to a partnership.* Section 721 applies to a contribution of QSB stock to a partnership. Except as provided in section 721(b), any gain that was not recognized by the taxpayer under section 1045 is not recognized when the taxpayer contributes QSB stock to a partnership in exchange for a partnership interest. Stock that is contributed to a partnership is not QSB stock in the hands of the partnership. See *Example 12* of paragraph (i) of this section.

(g) *Definitions.* For purposes of section 1045 and this section, the following terms are defined as follows:

(1) *Qualified small business stock.* The term *qualified small business stock* (QSB stock) has the meaning provided in section 1202(c). The term "QSB stock" does not include an interest in a partnership that purchases or holds QSB stock. See *Example 1* of paragraph (i) of this section.

(2) *Replacement QSB stock.* The term *replacement QSB stock* is any QSB stock purchased within 60 days beginning on the date of a sale of QSB stock.

(3) *Eligible partner*—(i) *In general.* Except as provided in paragraphs (e)(1), (g)(3)(ii), (iii) and (iv) of this section, an eligible partner with respect to QSB stock is a taxpayer other than a C corporation that holds an interest in a partnership on the date the partnership acquires the QSB stock and at all times thereafter for more than 6 months until the partnership sells or distributes the QSB stock.

(ii) *Acquisition by gift or at death.* For purposes of paragraph (g)(3)(i) of this section, a taxpayer who acquires from a partner (other than a C corporation) by gift or at death an interest in a partnership that holds QSB stock is treated as having held the acquired interest in the partnership during the period the partner (other than a C corporation) held the interest in the partnership.

(iii) *Tiered partnership.* For purposes of paragraph (g)(3)(i) of this section, if a partnership (upper-tier partnership) holds an interest in another partnership (lower-tier partnership) that holds QSB stock, then the upper-tier partnership's ownership of the lower-tier partnership is disregarded and each partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership directly. The partner of the upper-tier partnership is treated as owning the interest in the lower-tier partnership during the period in which both—

(A) The partner of the upper-tier partnership held an interest in the upper-tier partnership; and

(B) The upper-tier partnership held an interest in the lower-tier partnership. See *Examples 3* and *4* of paragraph (i) of this section.

(iv) *Multiple tiers of partnerships.* Principles similar to those described in paragraph (g)(3)(iii) of this section apply where a taxpayer holds an interest in a lower-tier partnership through multiple tiers of partnerships.

(4) *Month(s).* For purposes of this section, the term *month(s)* means a period commencing on the same numerical day of any calendar month as the day on which the QSB stock is sold and ending with the close of the day preceding the numerically corresponding day of the succeeding calendar month or, if there is no correspond-

ing day, with the last day of the succeeding calendar month.

(h) *Reporting and election rules*—(1) *Time and manner of making election.* A partnership making an election under section 1045 (as described under paragraph (b)(1) of this section) must do so on the partnership's timely filed (including extensions) Federal income tax return for the taxable year during which the sale of QSB stock occurs. A partner making an election under section 1045 (as described under paragraph (c)(1) of this section) must do so on the partner's timely filed (including extensions) Federal income tax return for the taxable year during which the partner's distributive share of the partnership's gain from the sale of the QSB stock is taken into account by such partner under section 706. In addition, a partnership or partner making an election under section 1045 must make such election in accordance with the applicable forms and instructions.

(2) *Purchases, distributions, and sales of QSB stock or replacement QSB stock by partnerships.* A partnership that purchases, distributes to a partner, or sells or exchanges QSB stock or replacement QSB stock must provide information to the Commissioner and to the partnership's partners to the extent provided by the applicable forms and instructions.

(3) *Nonrecognition of gain by eligible partners.* An eligible partner that does not recognize gain under section 1045 must provide information to the Commissioner to the extent provided by the applicable forms and instructions.

(i) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Sale of a partnership interest. On January 1, 2008, A, an individual, X, a C corporation, and Y, a C corporation, form PRS, a partnership. A, X, and Y each contribute $250 to PRS and agree to share all partnership items equally. PRS purchases QSB stock for $750 on February 1, 2008. On November 4, 2008, A sells A's interest in PRS for $500, realizing $250 of capital gain. Under paragraph (g)(1) of this section, an interest in a partnership that holds QSB stock is not treated as QSB stock. Therefore, the sale of an interest in a partnership that holds QSB stock is not treated as a sale of QSB stock, and A may not elect to apply section 1045 with respect to A's $250 gain from the sale of A's interest in PRS.

Example 2. Election by partner; replacement by partnership. (i) Assume the same facts as in *Example 1*, except that A does not sell A's interest in PRS. Instead, PRS sells the QSB stock (QSB1 stock) for $1,500 on November 3, 2008. PRS realizes $750 of gain from the sale of the QSB1 stock (none of which is treated as ordinary income) and allocates $250 of gain to each of A, X, and Y. PRS does not make a section 1045 election. On November 30, 2008, A contributes $500 to ABC, a partnership, in exchange for a 10 percent interest in ABC. ABC then purchases QSB stock (QSB2 stock) for $5,000 on December 1, 2008. ABC has no other assets. A makes an election under paragraph (c)(1) of this section and treats A's percentage interest in ABC's QSB2 stock as replacement QSB stock under paragraph (c)(1)(iii) of this section with respect to the $250 gain PRS allocated to A. Under paragraph (c)(3) of this section, A's share of the cost of QSB2 stock purchased by ABC is $500 (A's reasonably expected income and gain with respect to QSB2 stock, or 10 percent multiplied by the cost of the QSB2 stock, $5,000). Under paragraph (c)(1)(iii) of this section, A will not recognize the $250 gain PRS allocated to A, because A's share of the amount realized by PRS, $500 (the total amount realized by the partnership on the sale of the QSB1 stock ($1,500) multiplied by A's share of the gain from the sale of the QSB1 stock ($250) over the total gain realized by the partnership on the sale of the QSB1 stock ($750)), does not exceed A's share of ABC's cost of the QSB2 stock acquired by ABC, $500. Under paragraph (c)(4)(ii) of this section, A must reduce A's share of ABC's basis in the QSB2 stock by $250. Under paragraph (c)(4)(iii) of this section, A must reduce A's basis in A's interest in ABC by $250. Under paragraph (c)(4)(i) of this section, A's basis in A's interest in PRS is increased by $250.

(ii) Assume the same facts as in paragraph (i) of this *Example 2*, except that A does not contribute $500 to ABC in exchange for a partnership interest. Instead, on November 30, 2008, EFG, a partnership in which A has an existing 10 percent partnership interest, purchases QSB stock for $5,000. Under paragraph (c)(1) of this section, A may treat A's 10 percent interest in EFG's QSB stock as replacement QSB stock with respect to the $250 of gain PRS allocated to A.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that ABC owns QSB stock that ABC purchased on November 10, 2008, and ABC does not purchase QSB stock on December 1, 2008. Under paragraph (c)(1) of this section, ABC is not a purchasing partnership with respect to A for the QSB stock ABC purchased on November 10, 2008. A may not treat A's percentage interest in ABC's QSB stock as replacement QSB stock to defer the $250 gain PRS allocated to A, because A acquired its interest in ABC after ABC acquired the QSB stock.

(iv) Assume the same facts as in paragraph (i) of this *Example 2*, except that ABC sells QSB2 stock on July 30, 2009, for $5,000. ABC realizes no gain or loss on the sale of QSB2 stock. A desires to continue to rollover the $250 gain from the sale of QSB1 stock. Under paragraph (c)(2)(ii)(A) of this section, A's share of the amount realized is $500, which was A's share of the amount realized on the prior sale of QSB1 stock. Accordingly, A must elect to apply section 1045 and purchase $500 of replacement QSB stock either directly or through a purchasing partnership to continue to defer the $250 gain from the sale of QSB1 stock.

Example 3. Tiered partnerships; partnership election. (i) On January 1, 2008, A, an individual, and B, an individual, each contribute $500 to UTP, (upper-tier partnership) for equal partnership interests. On February 1, 2008, UTP and C, an individual, each contribute $1,000 to LTP, (lower-tier partnership) for equal partnership interests. On March 1, 2008, LTP purchases QSB stock for $500. On April 1, 2008, D, an individual, joins UTP by contributing $500 to UTP for a 1/3 interest in UTP. On December 1, 2008, LTP sells the QSB stock for $2000. Under paragraph (g)(3)(iii) of this section, A, B, and D are treated as owning an interest in LTP during the period in which each of the partners held an interest in UTP and UTP held an interest in LTP. Therefore, under paragraphs (g)(3)(i) and (iii) of this section, A and B are eligible partners, and D and UTP are not eligible partners with respect to the QSB stock sold by LTP. Under paragraph (g)(3)(i) of this section, C is also an eligible partner with respect to the QSB stock sold by LTP.

(ii) Assume the same facts as in paragraph (i) of this *Example 3*. LTP realizes a gain of $1,500 on the December 1, 2008, sale of QSB stock. LTP allocates $750 of gain to each of UTP and C. UTP, in turn, allocates $250 (of the $750 of gain allocated to UTP) to each of A, B, and D. LTP makes a section 1045 election. On January 1, 2009, LTP purchases replacement QSB stock for $2,000. Under paragraph (b)(5)(ii) of this section, D notifies UTP that it recognizes $250 of gain and UTP notifies LTP. Because A, B, and C are eligible partners with respect to the QSB stock sold by LTP, A and B may each defer $250 of LTP's section 1045 gain and C may defer $750 of LTP's section 1045 gain. LTP must decrease its basis in the replacement QSB stock by the $750 of partnership section 1045 gain that was allocated to C and by $500 of the partnership section 1045 gain that was allocated to UTP. These basis reductions are with respect to UTP (A and B) and C only. Under paragraph (b)(3)(ii)(B) of this section, the basis of UTP's interest in LTP attributable to the LTP's replacement QSB stock must be segregated and allocated to A and B. In addition, A and B each have a $250 negative basis adjustment in their respective interests in UTP. If UTP sells its interest in LTP for $1,250, A and B would each recognize $250 of gain from the sale of the LTP interest. D would not recognize any gain or loss from the sale.

Example 4. Tiered partnerships; partner election. (i) On January 1, 2008, A, an individual, and X, a C corporation, form UTP, a partnership. A and X each contribute $250 to UTP and agree to share all partnership items equally. Also, on January 1, 2008, UTP and Y, a C corporation, form LTP, a partnership. UTP and Y contribute $500 and $250, respectively, to LTP. UTP and Y agree to share all partnership items equally. LTP purchases QSB stock for $750 on February 1, 2008. On November 3, 2008, LTP sells the QSB stock for $1,500. LTP realizes $750 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $250 gain to Y and $500 gain to UTP. Of the $500 gain allocated to UTP from the sale of QSB stock, $250 is allocated to A and $250 is allocated to X. LTP purchases replacement QSB stock (replacement QSB1 stock) for $1,350 on December 15, 2008. LTP does not make an election under section 1045. Under the rules provided in paragraph (c) of this section, A makes an election under section 1045 on its timely filed return for the taxable year for which the distributive share of gain from the sale of QSB stock is taken into account by A under section 706. Under

paragraph (c)(1)(iii) of this section, A treats A's interest in replacement QSB1 stock as replacement stock with respect to A's distributive share of LTP's section 1045 gain. On March 30, 2009, LTP sells replacement QSB1 stock for $1,650. LTP realizes $300 of gain from the sale of replacement QSB1 stock (none of which is treated as ordinary income) and allocates $100 to Y and $200 to UTP.

(ii) Under paragraph (c)(1)(iii) of this section, A must recognize its distributive share of gain from LTP's sale of QSB stock ($250) only to the extent of the greater of A's distributive share of LTP's gain from the sale of QSB stock that is treated as ordinary income ($0) or the amount by which A's share of the amount realized by LTP's sale of QSB stock exceeds A's share of LTP's cost of the replacement QSB1 stock, $50 ($1/3^{rd}$ of $1,500, or $500, minus $1/3^{rd}$ of $1,350, or $450). Because Y is not an eligible partner of LTP under paragraph (g)(3) of this section, Y must recognize its $250 distributive share of partnership gain from the sale of the QSB stock. Also, X is not an eligible partner under paragraph (g)(3) of this section, and it must recognize its $250 distributive share of gain from UTP attributable to UTP's distributive share of $500 of LTP's gain from the sale of QSB stock.

(iii) Under section 705(a)(1), the adjusted basis of Y's interest in LTP is increased by $250, and the adjusted basis of UTP's interest in LTP is increased by $500. Under section 705(a)(1), the adjusted basis of X's interest in UTP is increased by $250, and the adjusted basis of A's interest in UTP is increased by $250. However, under paragraph (c)(4)(iii) of this section, the adjusted basis of A's interest in UTP is reduced by the $200 of partnership section 1045 gain that was not recognized by A.

(iv) Under paragraph (c)(4)(ii) of this section, the LTP's adjusted basis in replacement QSB1 stock is reduced by the $200 of gain from the sale of QSB stock that is not recognized by A, as a result of A's election under section 1045. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired. LTP's adjusted basis in the replacement QSB1 stock is maintained without regard to the eligible partner's adjustment provided in paragraph (c)(4)(ii) of this section.

(v) On the sale of replacement QSB1 stock, LTP realizes a gain of $300, $100 of which is allocated to Y and $200 of which is allocated to UTP. UTP allocates $100 of this gain to A. Under paragraph (c)(5) of this section, in determining A's amount recognized upon the sale of replacement QSB1 stock by LTP, A must take into account A's basis adjustment of $200. Accordingly, A recognizes a total gain of $300 upon the sale of replacement QSB1 stock, absent an additional section 1045 election by A or LTP. Under paragraph (c)(4)(iv) of this section, the adjusted basis of A's interest in UTP is increased by $300 under section 705(a)(1).

(vi) Assume the same facts as in paragraph (i) of this *Example 4*, except that UTP sells its entire interest in LTP on March 30, 2009, for $1,200. UTP realizes a gain of $200 on the sale of its interest in LTP ($1,200 amount realized less $1,000 adjusted basis) and allocates $100 of this gain to A. Under paragraph (c)(5) of this section, in determining A's amount recognized upon the sale of UTP's interest in LTP, A must take into account A's basis adjustment of $200. Accordingly, A recognizes a total gain of $300 upon the sale of the interest in LTP. Under paragraph (c)(4)(iv) of this section, the adjusted basis in A's interest in UTP is increased by $300 under section 705(a)(1).

Example 5. Partnership sale of QSB stock and purchase and sale of replacement QSB stock. (i) On January 1, 2008, A, an individual, X, a C corporation, and Y, a C corporation, form PRS, a partnership. A, X, and Y each contribute $250 to PRS and agree to share all partnership items equally. PRS purchases QSB stock for $750 on February 1, 2008. On November 3, 2008, PRS sells the QSB stock for $1,500. PRS realizes $750 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $250 of gain to each of A, X, and Y. PRS purchases replacement QSB stock (replacement QSB1 stock) for $1,350 on December 15, 2008. On its timely filed return for the taxable year during which the sale of the QSB stock occurs, PRS makes an election to apply section 1045. A does not make an election to apply section 1045 with respect to the November 3, 2008, sale of QSB stock. PRS knows that X and Y are C corporations. On March 30, 2009, PRS sells replacement QSB1 stock for $1,650. PRS realizes $300 of gain from the sale of replacement QSB1 stock (none of which is treated as ordinary income) and allocates $100 of gain to each of A, X, and Y. A does not make an election to apply section 1045 with respect to the March 30, 2009, sale of replacement QSB1 stock.

(ii) Under paragraph (b)(1) of this section, the partnership section 1045 gain from the November 3, 2008, sale of QSB stock is $600 ($750 gain less $150 ($1,500 amount realized on the sale of QSB stock less $1,350 cost of replacement QSB1 stock)). This amount must be allocated among the partners in the same proportions as the entire gain from the sale of QSB stock is allocated to the partners, 1/3 ($200) to A, 1/3 ($200) to X, and 1/3 ($200) to Y.

(iii) Because neither X nor Y is an eligible partner under paragraph (g)(3) of this section, X and Y must each recognize its $250 distributive share of partnership gain from the sale of QSB stock. Because A is an eligible partner under paragraph (g)(3) of this section, A may defer recognition of A's $200 distributive share of partnership section 1045 gain. A is not required to separately elect to apply section 1045. A must recognize A's remaining $50 distributive share of the partnership's gain from the sale of QSB stock.

(iv) Under section 705(a)(1), the adjusted bases of X's and Y's interests in PRS are each increased by $250. Under section 705(a)(1) and paragraph (b)(3)(i) of this section, the adjusted basis of A's interest in PRS is not increased by the $200 of partnership section 1045 gain that was not recognized by A, but is increased by A's remaining $50 distributive share of gain.

(v) PRS must decrease its basis in the replacement QSB1 stock by the $200 of partnership section 1045 gain that was allocated to A. This basis reduction is a reduction with respect to A only. PRS then adjusts A's distributive share of gain from the sale of replacement QSB1 stock to reflect the effect of A's basis adjustment under paragraph (b)(3)(ii) of this section. In accordance with the principles of §1.743–1(j)(3), the amount of A's gain from the March 30, 2009, sale of replacement QSB1 stock in which A has a $200 negative basis adjustment equals $300 (A's share of PRS's gain from the sale of replacement QSB1 stock ($100), increased by the amount of A's negative basis adjustment for replacement QSB1 stock ($200)). Accordingly, upon the sale of replacement QSB1 stock, A recognizes $300 of gain, and X and Y each recognize $100 of gain.

(vi) Assume the same facts as in paragraph (i) of this *Example 5*, except that PRS purchases replacement QSB stock (replacement QSB2 stock) on April 15, 2009, for $1,150 and PRS makes an election to apply section 1045 with respect to the March 30, 2009, sale of replacement QSB1 stock. Under paragraph (b)(3)(ii)(A) of this section, PRS' $200 basis adjustment in QSB1 stock relating to the November 3, 2008, sale of QSB stock carries over to the basis adjustment for QSB2 stock. This basis adjustment is an adjustment with respect to A only. The $200 basis adjustment is reduced by A's distributive share of the excess of $500 (the greater of the amount determined under paragraph (b)(1)(i), $0, or (ii) of this section, $500 ($1,650 amount realized on the sale of QSB1 stock less $1,150 cost of replacement QSB2 stock)) over $300 (PRS' gain from the sale of QSB1 stock), or $67 ($200 ($500 minus $300) divided by 3). Under paragraph (b)(3)(ii)(A), A must account for the $67 excess amount that reduces PRS' basis adjustment in QSB2 stock as gain in accordance with §1.743–1(j)(3). Therefore, A now has a $133 negative basis adjustment with respect to replacement QSB2 stock (($200) negative basis adjustment from the November 3, 2008, sale of QSB stock plus $67 positive basis adjustment from the March 30, 2009, sale of QSB1 stock). A also recognizes the $100 of gain allocated by PRS to A from the March 30, 2009, sale of replacement QSB1 stock for total gain recognition of $167 ($100 plus $67).

Example 6. Partnership sale of QSB stock; election by eligible partner; replacement QSB stock purchased by purchasing partnership. (i) Assume the same facts as in *Example 5* except that PRS does not make an election under section 1045 with respect to the sale of either the QSB stock on November 3, 2008, or the QSB1 stock on March 30, 2009. However, A makes an election under section 1045 with respect to the sale of QSB stock and treats the purchase of QSB1 stock on December 15, 2008, by PRS, as the purchase of replacement QSB stock. Additionally, A makes an election under section 1045 with respect to the sale of QSB1 stock and treats the purchase of QSB2 stock on April 15, 2009, by PRS, as the purchase of replacement QSB stock.

(ii) A's distributive share of gain from the November 3, 2008, sale of QSB stock is $250 (A's 1/3 interest in $750 of total PRS gain). Under paragraph (c)(1)(iii) of this section, A must recognize only $50 of A's distributive share of PRS' gain of $250, that is the excess of A's share of the amount realized on the sale of QSB stock, or $500 (the total amount realized by PRS on the sale of QSB stock ($1,500) multiplied by A's share of the gain from the sale of QSB stock ($250) over the total gain realized by PRS on the sale of QSB stock ($750)), minus A's share of PRS' cost of QSB1 stock, or $450 (1/3 of $1,350). Under section 705(a)(1) and paragraph (c)(4)(i) of this section, A's adjusted basis in its interest in PRS is increased by $250. However, under paragraph (c)(4)(iii) of this section, because PRS is a purchasing partnership, A's adjusted basis of its interest in PRS is then reduced by the deferred gain of

$200. Also under paragraph (c)(4)(ii) of this section, PRS' adjusted basis in QSB1 stock is reduced by the gain not recognized of $200 and A must take into account such adjusted basis in computing A's income, gain, loss or deduction with respect to QSB1 stock. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired.

(iii) A's distributive share of gain from the March 30, 2009, sale of QSB1 stock is $100 (A's 1/3 interest in $300 of total PRS gain) and under paragraph (c)(5) of this section, A must take into account A's $200 basis adjustment with respect to the QSB1 stock that was sold. Accordingly, A's total gain from the sale of QSB1 stock is $300. Under paragraph (c)(1)(iii) of this section, A must recognize only $167 of A's total gain of $300, that is, the excess of A's share of the amount realized on the sale of QSB1 stock, or $550 (the total amount realized by PRS on the sale of QSB1 stock ($1,650) multiplied by A's share of the gain from the sale of QSB1 stock ($100) over the total gain realized by PRS on the sale of QSB1 stock ($300)) minus A's share of PRS' cost of QSB2 stock, or $383 (1/3 of $1,150). Under section 705(a)(1), A's adjusted basis in A's interest in PRS is increased by A's $100 distributive share of gain from the sale of QSB1 stock. Under paragraph (c)(4)(iv) of this section, A's adjusted basis of A's interest in PRS is increased by the additional $67 of gain recognized under paragraph (c)(5) of this section. Also, under paragraph (c)(4)(ii) of this section, PRS' adjusted basis in QSB2 stock is reduced by the gain not recognized of $133 ($300 minus $167) and A must take into account such adjusted basis in computing A's income, gain, loss or deduction with respect to QSB2 stock. A must retain records setting forth the computation of this basis adjustment, the replacement QSB stock to which the adjustment is made, and dates the stock was acquired.

Example 7. Partnership sale of QSB stock and partner purchase of replacement QSB stock. (i) Assume the same facts as in paragraph (i) of *Example 5*, except that PRS does not make an election under section 1045 with respect to the sale of the QSB stock and does not purchase replacement QSB stock. On November 30, 2008, A, an eligible partner under paragraph (g)(3) of this section, purchases replacement QSB stock for $500. A elects pursuant to paragraph (c) of this section to apply section 1045 on A's timely filed return for the taxable year that A is required to include A's distributive share of PRS' gain from the sale of the QSB stock.

(ii) Under paragraph (c)(2) of this section, A's share of the amount realized from PRS' sale of the QSB stock is $500 (the total amount realized by the partnership on the sale of the QSB stock ($1,500) multiplied by A's share of the gain from the sale of the QSB stock ($250) over the total gain realized by the partnership on the sale of the QSB stock ($750)). Because A purchased, within 60 days of PRS' sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made an election pursuant to paragraph (c) of this section to apply section 1045, A defers recognition of A's $250 distributive share of gain from PRS' sale of the QSB stock. Under section 705(a)(1) and paragraph (c)(4)(i) of this section, the adjusted basis of A's interest in PRS is increased by $250. Under paragraph (c)(4)(ii) of this section, A's adjusted basis in the replacement QSB stock is $250 ($500 cost minus $250 nonrecognition amount).

Example 8. Partial replacement by partnership; partial replacement by partner. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $1,000 and subsequently sells the QSB stock on January 31, 2010, for $3,000. PRS realizes $2,000 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $1,000 of gain to each of A and X. On February 10, 2010, PRS purchases replacement QSB stock for $2,200. On March 20, 2010, A purchases replacement QSB stock for $400. PRS makes an election to apply section 1045 under paragraph (b)(1) of this section with respect to the partnership section 1045 gain from the sale of QSB stock and A does not opt out of PRS' section 1045 election under paragraph (b)(4) of this section. Also, A makes an election under paragraph (c)(1) of this section with respect to the remaining gain from the sale of the QSB stock.

(ii) Under paragraph (b)(1) of this section, partnership section 1045 gain is $1,200 ($2,000 less $800 ($3,000 amount realized on the sale of the QSB stock minus $2,200 cost of the replacement QSB stock)). This amount is allocated among the partners in the same proportions as the entire gain from the sale of the QSB stock is allocated to the partners, 1/2 to A ($600), and 1/2 to X ($600). Because A is an eligible partner, A defers recognition of A's $600 distributive share of partnership section 1045 gain.

(iii) A also made an election under section 1045 and purchased, within 60 days of PRS' sale of the QSB stock, replacement QSB stock for $400. Therefore, under paragraph (c)(1) of this section, A may defer a portion of A's distributive share of the remaining gain from the partnership's sale of the QSB stock. A must recognize that remaining gain to the extent that A's share of the amount realized by PRS on the sale of the QSB stock (excluding the cost of the QSB stock that was replaced by PRS) exceeds the cost of the replacement QSB stock purchased by A during the 60-day period following the sale of the QSB stock. The amount realized by PRS on the sale of the QSB stock (excluding the cost of the QSB stock that was replaced by PRS) is $800 ($3,000 minus $2,200). Under paragraph (c)(2) of this section, A's share of that amount realized is $400 ($1,000 (A's share of the realized gain from the sale of the QSB stock) / $2,000 (PRS total realized gain from the sale of the QSB stock) multiplied by $800). Because the replacement QSB stock purchased by A cost $400, A defers recognition of all of the remaining gain from the sale of the QSB stock.

(iv) The adjusted basis of A's interest in PRS is not increased by the $600 gain that was not recognized pursuant to paragraph (b)(1) of this section, but is increased by the $400 gain that was not recognized pursuant to paragraph (c)(1) of this section. See paragraphs (b)(3)(i) and (c)(4)(i) of this section. PRS must decrease its basis in the replacement QSB stock by the $600 of partnership section 1045 gain that was allocated to A. See paragraph (b)(3)(ii) of this section. A must decrease A's basis in the replacement QSB stock purchased by A by the $400 not recognized pursuant to paragraph (c)(1) of this section. See paragraph (c)(4)(ii) of this section.

Example 9. Change in partner's interest in partnership while partnership holds QSB stock. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $1,000. On August 2, 2008, A sells a 25 percent interest in PRS to Z. On July 10, 2009, A repurchases the 25 percent interest from Z for $500. PRS makes a timely election under section 754 for the 2008 taxable year. Under section 743(b), A has a positive basis adjustment of $250. On January 31, 2011, PRS sells the QSB stock for $3,000. PRS realizes $2,000 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $1,000 of gain to each of A and X. On February 10, 2010, PRS purchases replacement QSB stock for $3,000. PRS makes an election to apply section 1045 under paragraph (b)(1) of this section with respect to the partnership section 1045 gain from the sale of QSB stock.

(ii) Of the $2,000 of realized gain from the sale of the QSB stock, PRS allocates $1,000 to A and $1,000 to X. However, A has a positive basis adjustment of $250 under section 743(b) as a result of the purchase of the 25 percent interest in PRS from Z; therefore, A's share of the gain is reduced to $750. Because A is an eligible partner under paragraph (g)(3) of this section, A may defer recognition of A's distributive share of gain from the sale of the QSB stock subject to the nonrecognition limitation described in paragraph (d) of this section. The smallest percentage interest that A held in PRS capital during the time that PRS held the QSB stock is 25 percent. Under the nonrecognition limitation, A may not defer more than 25 percent of the partnership gain realized from the sale of the QSB stock (determined without regard to any basis adjustment under section 734(b) or section 743(b), other than a basis adjustment described in paragraph (b)(3)(ii) of this section). Because the partnership's realized gain determined without regard to A's basis adjustment under section 743(b) is $2,000, A may defer recognition of $500 (25 percent of $2,000) of the gain from the sale of the QSB stock. A must recognize the remaining $250 of that gain.

Example 10. Sale by partner of QSB stock received in a liquidating distribution. (i) On January 1, 2008, A, an individual, and X, a C corporation, form PRS, a partnership. A and X each contribute $1,500 to PRS and agree to share all partnership items equally. PRS purchases QSB stock on February 1, 2008, for $3,000. On May 1, 2008, when the QSB stock has appreciated in value to $4,000, A contributes $1,000 to PRS, increasing A's interest in PRS capital to 60 percent. On June 1, 2011, when the QSB stock is still worth $4,000, PRS makes a liquidating distribution of $3,000 worth of QSB stock to A. Under section 732, A's basis in the distributed QSB stock is $2,500. A sells the QSB stock on August 4, 2011, for $6,000, realizing a gain of $3,500 (none of which is treated as ordinary income). A purchases replacement QSB stock on August 30, 2011, for $5,500, and makes an election under section 1045 with respect to the August 4, 2011, sale of QSB stock.

(ii) A is an eligible partner under paragraph (g)(3) of this section. Therefore, under paragraph (e)(1) of this section, A is treated as having acquired the distributed QSB stock in the same manner as PRS and as having held the QSB stock since February 1, 2008, its original issue date. Because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock, A is eligible to defer a portion of A's gain from the sale of the QSB stock. A must recognize gain, however, to the extent that A's amount realized on the sale of the QSB stock, $6,000, exceeds the cost of the replacement QSB stock purchased by A during the 60-day period beginning on the date of the sale of the QSB stock, $5,500. Accordingly, A must recognize $500 of the gain from the sale of the QSB stock. A defers recognition of the remaining $3,000 of gain to the extent that such gain does not exceed the distribution nonrecognition limitation under paragraph (e)(3) of this section.

(iii) Under paragraph (e)(3)(i) of this section, A's nonrecognition limitation with respect to the sale of the QSB stock is A's section 1045 amount realized with respect to the stock, reduced by A's section 1045 adjusted basis with respect to the stock. A's amount realized from the sale is the product of A's amount realized from the sale, $6,000; and a fraction—

(*1*) The numerator of which is A's smallest percentage interest in PRS capital with respect to such stock, 50 percent; and

(*2*) The denominator of which is A's percentage interest in that type of partnership QSB stock immediately after the distribution, 75 percent (the value of the stock distributed to A, $3,000, divided by the value of all QSB stock of that type acquired by PRS, $4,000).

(iv) Therefore, A's section 1045 amount realized is $4,000 ($6,000 multiplied by 50/75). Because PRS distributed the QSB stock to A in liquidation of A's interest in PRS, A's section 1045 adjusted basis is the product of PRS' basis in all of the QSB stock of the type distributed, $3,000; A's smallest percentage interest in PRS capital with respect to QSB stock of the type distributed, 50 percent; and the percentage of the distributed QSB stock that was sold by A, 100 percent. Therefore, A's section 1045 adjusted basis is $1,500 (the product of $3,000, 50 percent, and 100 percent)) and A's nonrecognition limitation amount on the sale of the QSB stock is $2,500 ($4,000 section 1045 amount realized minus $1,500 section 1045 adjusted basis). Accordingly, A defers recognition of $2,500 of the remaining $3,000 gain from the sale of the QSB stock and must recognize $500 of the remaining $3,000 gain. Accordingly, A's total gain recognized from the sale of the QSB stock is $1,000.

(v) A's basis in the replacement QSB stock is $3,000 (cost of the replacement QSB stock, $5,500, reduced by the gain not recognized under section 1045, $2,500).

Example 11. Sale by partner of QSB stock received in a nonliquidating distribution. (i) The facts are the same as in *Example 10*, except that, on June 1, 2011, PRS distributes only $2,000 of the QSB stock to A, reducing A's interest in PRS capital from 60 percent to 33 percent. PRS' basis in the distributed QSB stock is $1,500. On November 1, 2011, A sells for $2,500 the QSB stock distributed by PRS to A and purchases, within 60 days of the date of sale of the QSB stock, replacement QSB stock for $2,500. A makes a timely election to apply section 1045 with respect to A's sale of the distributed QSB stock.

(ii) Under section 732, A's basis in the distributed QSB stock is $1,500. Therefore, A realizes a gain on the sale of the distributed QSB stock of $1,000. Because A made an election to apply section 1045 to the sale, and because A purchased, within 60 days of A's sale of the QSB stock, replacement QSB stock at a cost equal to the amount realized on the sale of the distributed QSB stock, A defers recognition of the gain from the sale of the QSB stock to the extent that such gain does not exceed the distribution nonrecognition limitation.

(iii) Under paragraph (e)(3) of this section, the nonrecognition limitation with respect to A's sale of the QSB stock is A's section 1045 amount realized reduced by A's section 1045 adjusted basis. Because PRS did not distribute all of the particular type of QSB stock and the distribution of the QSB stock to A was not in liquidation of A's interest in PRS, under paragraph (e)(3)(ii)(C) of this section A's section 1045 amount realized is $1,250 (A's amount realized from the sale of the distributed QSB stock, $2,500, multiplied by A's smallest percentage interest in PRS capital with respect to such stock, 50 percent). Under paragraph (e)(3)(iii)(B) of this section, A's section 1045 adjusted basis is the product of the partnership's basis in the QSB stock sold by the partner, $1,500, and A's smallest percentage interest in the partnership capital with respect to such stock, 50 percent. Therefore, A's section 1045 adjusted basis is $750 (50 percent of $1,500), and A's nonrecognition limitation amount on the sale of the QSB stock is $500 ($1,250 section 1045 amount realized minus $750 section 1045 adjusted basis). As this amount is less than the amount of gain that A is eligible to defer under section 1045, $1,000, A defers recognition of only $500 of the gain from the sale of the QSB stock. A must recognize the remaining $500 of that gain.

(iv) A's basis in the replacement QSB stock is $2,000 (cost of the replacement QSB stock, $2,500, reduced by the gain not recognized under section 1045, $500).

Example 12. Contribution of replacement QSB stock to a partnership. (i) On January 1, 2008, A, an individual, B, an individual, and X, a C corporation, form PRS, a partnership. A, B, and X each contribute $250 to PRS and agree to share all partnership items equally. On February 1, 2008, PRS purchases QSB stock for $750. PRS sells the QSB stock on November 3, 2008, for $1,050. PRS realizes $300 of gain from the sale of the QSB stock (none of which is treated as ordinary income) and allocates $100 of gain to each of its partners. PRS informs the partners that it does not intend to make an election under section 1045 with respect to the sale of the QSB stock. Each partner's share of the amount realized from the sale of the QSB stock is $350. On November 30, 2008, A, an eligible partner within the meaning of paragraph (g)(3) of this section, purchases replacement QSB stock for $350 and makes a section 1045 election under paragraph (c)(1) of this section. Subsequently, A transfers the replacement QSB stock to ABC, a partnership, in exchange for an interest in ABC.

(ii) Because A purchased within 60 days of PRS's sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made a valid election to apply section 1045 with respect to A's share of the gain from PRS's sale of the QSB stock, A does not recognize A's $100 distributive share of the gain from PRS's sale of the QSB stock. Before the contribution of the replacement QSB stock to ABC, A's adjusted basis in the replacement QSB stock is $250 ($350 cost minus $100 nonrecognition amount). A does not recognize gain upon the contribution of QSB stock to ABC under section 721(a). Upon the contribution of the replacement QSB stock to ABC, A's basis in the ABC partnership interest is $250, and ABC's basis in the replacement QSB stock is $250. However, the replacement QSB stock does not qualify as QSB stock in ABC's hands. Neither A nor ABC will be eligible to defer gain under section 1045 on a subsequent sale of the replacement QSB stock.

(j) *Effective/applicability date—In general.* This section applies to sales of QSB stock on or after August 14, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101 paragraph (b) is amended by adding in numerical order, §1.1045–1, to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1045–1	1545–1893
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2007, 72 F.R. 45346)

Part III. Administrative, Procedural, and Miscellaneous

Information Reporting by Organizations That Receive Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes

Notice 2007–70

SECTION 1. PURPOSE

This notice provides information on where to file a completed Form 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, an information form used by a donee organization to report a contribution of a qualified vehicle with a claimed value of more than $500, for calendar years ending on or after December 31, 2008. This notice changes where to file a completed Form 1098–C as described in Section 3 of Notice 2006–1, 2006–1 C.B. 347.

SECTION 2. BACKGROUND

Notice 2006–1, 2006–1 C.B. 347, provides guidance on the reporting requirements under § 170(f)(12)(D) of the Internal Revenue Code, which apply to any donee organization that receives a contribution of a qualified vehicle after December 31, 2004, the claimed value of which is more than $500. Notice 2006–1, Section 3, provides that if a donee organization receives a contribution of a qualified vehicle, with a claimed value of more than $500, after December 31, 2004, the donee organization is required to provide a contemporaneous written acknowledgment to the donor. Notice 2006–1 specifies that the donee organization may use a completed Form 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, for the contemporaneous written acknowledgment. The notice also specifies that the Form 1098–C along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, be filed with the Internal Revenue Service Center, Ogden, UT 84201–0027.

SECTION 3. WHERE TO FILE A FORM 1098–C, CONTRIBUTIONS OF MOTOR VEHICLES, BOATS, AND AIRPLANES

All Forms 1098–C, *Contributions of Motor Vehicles, Boats, and Airplanes*, along with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, filed after December 31, 2007, must be filed with the Internal Revenue Service Center, Kansas City, MO 64999. The Internal Revenue Service Center at Ogden remains the location for Form 1098–C filed on or before December 31, 2007. Future changes to the filing location for Form 1098–C will be announced and placed in the instructions to Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*.

The filing instructions for Form 1098–C in Section 3 of Notice 2006–1, 2006–1 C.B. 347, are hereby modified.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Carolyn Ibok of Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Carolyn Ibok at (202) 283–8923 (not a toll-free call).

Qualified Transportation Fringes

Notice 2007–76

The purpose of this notice is to delay the effective date of Revenue Ruling 2006–57, 2006–47 I.R.B. 911. Revenue Ruling 2006–57 provides guidance to employers on the use of smartcards, debit or credit cards, or other electronic media to provide qualified transportation fringes under Internal Revenue Code §§ 132(a)(5) and 132(f). Treasury and the IRS have become aware that certain transit systems may need additional time to modify their technology and make it compatible with the requirements for vouchers set forth in Revenue Ruling 2006–57. Therefore, the ruling's effective date, which was set for January 1, 2008, is delayed to January 1, 2009. Nevertheless, employers and employees may rely on Revenue Ruling 2006–57 with respect to transactions occurring prior to January 1, 2009. The principal author of this notice is Michael R. Skutley of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this notice, contact Mr. Skutley at (202) 622–6040 (not a toll-free call).

Determination of Housing Cost Amounts Eligible for Exclusion or Deduction for 2007

Notice 2007–77

SECTION 1. PURPOSE

This notice provides adjustments to the limitation on housing expenses for purposes of section 911 of the Internal Revenue Code (Code) for specific locations for 2007. These adjustments are made on the basis of geographic differences in housing costs relative to housing costs in the United States.

SECTION 2. BACKGROUND

Section 911(a) of the Code allows a qualified individual to elect to exclude from gross income the foreign earned income and housing cost amount of such individual. Section 911(c)(1) defines the term "housing cost amount" as an amount equal to the excess of (A) the housing expenses of an individual for the taxable year to the extent such expenses do not exceed the amount determined under section 911(c)(2), over (B) 16 percent of the exclusion amount (computed on a daily basis) in effect under section 911(b)(2)(D) for the calendar year in which such taxable year begins ($70.44 per day for 2007, or $85,700 for the full year), multiplied by the number of days of that taxable year within the applicable period described in section 911(d)(1). The applicable period is the period during which the individual

meets the tax home requirement of section 911(d)(1) and either the *bona fide* residence requirement of section 911(d)(1)(A) or the physical presence requirement of section 911(d)(1)(B). Assuming that the entire taxable year of a qualified individual is within the applicable period, the section 911(c)(1)(B) amount for 2007 is $13,712 ($85,700 x .16).

Section 911(c)(2)(A) of the Code limits the housing expenses taken into account in section 911(c)(1)(A) to an amount equal to (i) 30 percent (adjusted as may be provided under the Secretary's authority under section 911(c)(2)(B)) of the amount in effect under section 911(b)(2)(D) for the calendar year in which the taxable year of the individual begins, multiplied by (ii) the number of days of that taxable year within the applicable period described in section 911(d)(1). Thus, under this general limitation, a qualified individual whose entire taxable year is within the applicable period is limited to maximum housing expenses of $25,710 ($85,700 x .30) in 2007.

Section 911(c)(2)(B) of the Code authorizes the Secretary to issue regulations or other guidance to adjust the percentage under section 911(c)(2)(A)(i) based on geographic differences in housing costs relative to housing costs in the United States. Pursuant to this authority, the Internal Revenue Service (IRS) and the Treasury Department published Notice 2006–87, 2006–43 I.R.B. 766, and Notice 2007–25, 2007–12 I.R.B. 760, to provide adjustments to the limitation on housing expenses for 2006 for qualified individuals incurring housing expenses in countries with high housing costs relative to housing costs in the United States.

SECTION 3. TABLE OF ADJUSTED LIMITATIONS FOR 2007

The following table provides adjusted limitations on housing expenses (in lieu of the otherwise applicable limitation of $25,710) for 2007.

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Argentina	Buenos Aires	120.27	43,900
Australia	Canberra	70.68	25,800
Australia	Melbourne	72.60	26,500
Australia	Perth	109.59	40,000
Austria	Vienna	78.97	28,824
Bahamas, The	Nassau	136.16	49,700
Bahrain	Bahrain	120.55	44,000
Barbados	Barbados	103.29	37,700
Belgium	Antwerp	98.90	36,100
Belgium	Brussels	137.53	50,200
Belgium	Gosselies	98.90	36,100
Belgium	Hoogbuul	98.90	36,100
Belgium	Mons	98.90	36,100
Belgium	SHAPE/Chievres	98.90	36,100
Bermuda	Bermuda	197.26	72,000
Bosnia-Herzegovina	Sarajevo	74.52	27,200
Brazil	Brasilia	101.64	37,100
Brazil	Rio de Janeiro	96.16	35,100
Brazil	Sao Paolo	127.40	46,500
Canada	Calgary	109.04	39,800
Canada	Dartmouth	92.88	33,900
Canada	Edmonton	83.01	30,300
Canada	Halifax	92.88	33,900
Canada	London/Ontario	79.18	28,900
Canada	Montreal	153.97	56,200
Canada	Ottawa	118.90	43,400

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Canada	Toronto	126.03	46,000
Canada	Vancouver	122.19	44,600
Canada	Victoria	92.33	33,700
Canada	Winnipeg	80.00	29,200
Chile	Santiago	96.71	35,300
China	Beijing	134.62	49,137
China	Hong Kong	313.15	114,300
China	Shanghai	156.17	57,001
Colombia	Bogota	148.22	54,100
Colombia	All cities other than Bogota and Barranquilla	123.01	44,900
Costa Rica	San Jose	71.78	26,200
Dominican Republic	Santo Domingo	110.96	40,500
Ecuador	Guayaquil	84.38	30,800
Ecuador	Quito	83.56	30,500
France	Garches	238.90	87,200
France	Le Havre	105.48	38,500
France	Lyon	149.32	54,500
France	Marseille	139.73	51,000
France	Montpellier	123.84	45,200
France	Paris	238.90	87,200
France	Sevres	238.90	87,200
France	Suresnes	238.90	87,200
France	Versailles	238.90	87,200
Germany	Babenhausen	116.97	42,700
Germany	Bad Aibling	99.73	36,400
Germany	Bad Nauheim	93.42	34,100
Germany	Baumholder	106.58	38,900
Germany	Berlin	143.29	52,300
Germany	Birkenfeld	106.58	38,900
Germany	Boeblingen	127.40	46,500
Germany	Butzbach	91.51	33,400
Germany	Darmstadt	116.99	42,700
Germany	Erlangen	74.25	27,100
Germany	Frankfurt am Main	122.19	44,600
Germany	Friedberg	93.42	34,100
Germany	Fuerth	74.25	27,100
Germany	Garmisch-Partenkirchen	101.10	36,900
Germany	Geilenkirchen	80.27	29,300

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Germany	Gelnhausen	126.58	46,200
Germany	Germersheim	88.77	32,400
Germany	Giebelstadt	101.40	37,000
Germany	Giessen	91.51	33,400
Germany	Grafenwoehr	75.89	27,700
Germany	Hanau	126.58	46,200
Germany	Hannover	87.40	31,900
Germany	Heidelberg	116.71	42,600
Germany	Idar-Oberstein	106.58	38,900
Germany	Ingolstadt	125.75	45,900
Germany	Kaiserslautern, Landkreis	130.41	47,600
Germany	Kitzingen	101.40	37,000
Germany	Leimen	116.71	42,600
Germany	Ludwigsburg	127.40	46,500
Germany	Mainz	143.84	52,500
Germany	Mannheim	116.71	42,600
Germany	Munich	125.75	45,900
Germany	Nellingen	127.40	46,500
Germany	Neubruecke	106.58	38,900
Germany	Nuernberg	74.25	27,100
Germany	Ober Ramstadt	116.99	42,700
Germany	Oberammergau	101.10	36,900
Germany	Pirmasens	130.41	47,600
Germany	Rheinau	116.71	42,600
Germany	Schwabach	74.25	27,100
Germany	Schwetzingen	116.71	42,600
Germany	Seckenheim	116.71	42,600
Germany	Sembach	130.41	47,600
Germany	Stuttgart	127.40	46,500
Germany	Wertheim	101.40	37,000
Germany	Wiesbaden	143.84	52,500
Germany	Wuerzberg	101.40	37,000
Germany	Zirndorf	74.25	27,100
Germany	Zweibrueken	130.41	47,600

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Germany	All cities other than Augsburg, Babenhausen, Bad Aibling, Bad Kreuznach, Bad Nauheim, Baumholder, Berchtesgaden, Berlin, Birkenfeld, Boeblingen, Bonn, Bremen, Bremerhaven, Butzbach, Cologne, Darmstadt, Delmenhorst, Duesseldorf, Erlangen, Flensburg, Frankfurt am Main, Friedberg, Fuerth, Garlstedt, Garmisch-Partenkirchen, Geilenkirchen, Gelnhausen, Germersheim, Giebelstadt, Giessen, Grafenwoehr, Grefrath, Greven, Gruenstadt, Hamburg, Hanau, Handorf, Hannover, Heidelberg, Heilbronn, Herongen, Idar-Oberstein, Ingolstadt, Kaiserslautern, Landkreis, Kalkar, Karlsruhe, Kerpen, Kitzingen, Koblenz, Leimen, Leipzig, Ludwigsburg, Mainz, Mannheim, Moenchen-Gladbach, Muenster, Munich, Nellingen, Neubruecke, Noervenich, Nuernberg, Ober Ramstadt, Oberammergau, Osterholz-Scharmbeck, Pirmasens, Rheinau, Rheinberg, Schwabach, Schwetzingen, Seckenheim, Sembach, Stuttgart, Twisteden, Wahn, Wertheim, Wiesbaden, Worms, Wuerzburg, Zirndorf and Zweibrueken.	103.29	37,700
Greece	Athens	94.25	34,400
Greece	Argyroupolis	91.23	33,300
Greece	Elefsis	94.25	34,400
Greece	Ellinikon	94.25	34,400
Greece	Mt. Hortiatis	91.23	33,300
Greece	Mt. Parnis	94.25	34,400
Greece	Mt. Pateras	94.25	34,400
Greece	Nea Makri	94.25	34,400
Greece	Perivolaki	91.23	33,300
Greece	Piraeus	94.25	34,400

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Greece	Souda Bay (Crete)	72.88	26,600
Greece	Tanagra	94.25	34,400
Greece	Thessaloniki	91.23	33,300
Guatemala	Guatemala City	103.01	37,600
Holy See, The	Holy See, The	159.18	58,100
Hungary	Budapest	89.04	32,500
India	Mumbai	156.19	57,011
India	New Delhi	73.75	26,920
Indonesia	Jakarta	103.49	37,776
Ireland	Dublin	80.55	29,400
Ireland	Limerick	80.00	29,200
Ireland	Shannon Area	80.00	29,200
Italy	Catania	78.63	28,700
Italy	Genoa	103.29	37,700
Italy	Gioia Tauro	85.48	31,200
Italy	La Spezia	103.29	37,700
Italy	Leghorn	99.45	36,300
Italy	Milan	237.53	86,700
Italy	Naples	131.23	47,900
Italy	Pisa	99.45	36,300
Italy	Pordenone-Aviano	109.59	40,000
Italy	Rome	159.18	58,100
Italy	Sardinia	81.37	29,700
Italy	Sigonella	78.63	28,700
Italy	Turin	118.63	43,300
Italy	Verona	75.89	27,700
Italy	Vicenza	110.68	40,400
Italy	All cities other than Avellino, Brindisi, Catania, Florence, Gaeta, Genoa, Gioia Tauro, La Spezia, Leghorn, Milan, Mount Vergine, Naples, Nettuno, Pisa, Pordenone-Aviano, Rome, Sardinia, Sigonella, Turin, Verona and Vicenza.	91.23	33,300
Jamaica	Kingston	112.88	41,200
Japan	Akashi	73.70	26,900
Japan	Atsugi	93.15	34,000
Japan	Camp Zama	93.15	34,000
Japan	Chiba-Ken	93.15	34,000

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Japan	Fussa	93.15	34,000
Japan	Gifu	80.00	29,200
Japan	Gotemba	75.07	27,400
Japan	Haneda	93.15	34,000
Japan	Kanagawa-Ken	93.15	34,000
Japan	Komaki	80.00	29,200
Japan	Machida-Shi	93.15	34,000
Japan	Nagoya	103.52	37,786
Japan	Okinawa Prefecture	123.56	45,100
Japan	Osaka-Kobe	145.30	53,036
Japan	Sagamihara	93.15	34,000
Japan	Saitama-Ken	93.15	34,000
Japan	Sasebo	73.70	26,900
Japan	Tachikawa	93.15	34,000
Japan	Tokyo	234.79	85,700
Japan	Tokyo-to	99.73	36,400
Japan	Yokohama	131.23	47,900
Japan	Yokosuka	113.42	41,400
Japan	Yokota	93.15	34,000
Korea	Camp Carroll	77.53	28,300
Korea	Camps Market	179.18	65,400
Korea	Chinhae	83.01	30,300
Korea	Chunchon	76.99	28,100
Korea	Colbern	179.18	65,400
Korea	K–16	179.18	65,400
Korea	Kimhae	86.03	31,400
Korea	Kimpo Airfield	179.18	65,400
Korea	Kwangju	82.19	30,000
Korea	Mercer	179.18	65,400
Korea	Munsan	75.62	27,600
Korea	Osan AB	93.42	34,100
Korea	Pusan	86.03	31,400
Korea	Pyongtaek	93.42	34,100
Korea	Seoul	179.18	65,400
Korea	Suwon	179.18	65,400
Korea	Taegu	97.53	35,600
Korea	Tongduchon	75.62	27,600
Korea	Uijongbu	106.85	39,000
Korea	Waegwan	77.53	28,300

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Korea	All cities other than Ammo Depot #9, Camp Carroll, Camps Market, Changwon, Chinhae, Chunchon, Colbern, K–16, Kimhae, Kimpo Airfield, Kunsun, Kwangju, Mercer, Munsan, Osan AB, Pusan, Pyongtaek, Seoul, Suwon, Taegu, Tongduchon, Uijongbu, and Waegwan.	87.40	31,900
Kuwait	Kuwait City	166.85	60,900
Kuwait	All cities other than Kuwait City	149.59	54,600
Luxembourg	Luxembourg	130.68	47,700
Macedonia	Skopje	96.99	35,400
Malaysia	Kuala Lumpur	131.50	48,000
Malaysia	All cities other than Kuala Lumpur	92.33	33,700
Malta	Malta	108.22	39,500
Mexico	Hermosillo	91.23	33,300
Mexico	Mazatlan	81.92	29,900
Mexico	Mexico City	116.16	42,400
Mexico	Monterrey	108.49	39,600
Mexico	All cities other than Ciudad Juarez, Cuernavaca, Guadalajara, Hermosillo, Matamoros, Mazatlan, Merida, Metapa, Mexico City, Monterrey, Nogales, Nuevo Laredo, Tapachula, Tijuana, Tuxtla Gutierrez, Veracruz.	103.84	37,900
Netherlands	Amsterdam	144.93	52,900
Netherlands	Aruba	98.63	36,000
Netherlands	Brunssum	90.14	32,900
Netherlands	Eygelshoven	90.14	32,900
Netherlands	Hague, The	163.29	59,600
Netherlands	Heerlen	90.14	32,900
Netherlands	Hoensbroek	90.14	32,900
Netherlands	Hulsberg	90.14	32,900
Netherlands	Kerkrade	90.14	32,900
Netherlands	Landgraaf	90.14	32,900
Netherlands	Maastricht	90.14	32,900
Netherlands	Papendrecht	114.52	41,800

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Netherlands	Rotterdam	114.52	41,800
Netherlands	Schaesburg	90.14	32,900
Netherlands	Schinnen	90.14	32,900
Netherlands	Schiphol	144.93	52,900
Netherlands	Ypenburg	163.29	59,600
Netherlands	All cities other than Amsterdam, Aruba, Brunssum, Coevorden, Eygelshoven, The Hague, Heerlen, Hoensbroek, Hulsberg, Kerkrade, Landgraaf, Maastricht, Margraten, Papendrecht, Rotterdam, Schaesburg, Schinnen, Schiphol, and Ypenburg.	83.29	30,400
New Zealand	Auckland	97.81	35,700
New Zealand	Wellington	92.60	33,800
Nicaragua	Managua	87.12	31,800
Norway	Oslo	83.76	30,573
Norway	Stavanger	96.44	35,200
Norway	All cities other than Oslo and Stavanger.	98.08	35,800
Panama	Panama City	88.22	32,200
Peru	Lima	74.79	27,300
Philippines	Cavite	98.63	36,000
Philippines	Manila	98.63	36,000
Poland	Poland	72.33	26,400
Portugal	Alverca	145.48	53,100
Portugal	Lajes Field	71.78	26,200
Portugal	Lisbon	145.48	53,100
Qatar	Doha	95.30	34,786
Russia	Moscow	249.04	90,900
Russia	Saint Petersburg	113.70	41,500
Russia	Sakhalin Island	212.33	77,500
Russia	Vladivostok	212.33	77,500
Russia	Yekaterinburg	129.86	47,400
Rwanda	Kigali	86.30	31,500
Saudi Arabia	Jeddah	84.02	30,667
Saudi Arabia	Riyadh	84.02	30,667
Singapore	Singapore	155.34	56,700
South Africa	Pretoria	110.14	40,200

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
Spain	Barcelona	108.49	39,600
Spain	Madrid	107.67	39,300
Spain	Rota	92.60	33,800
Spain	Valencia	111.51	40,700
Switzerland	Bern	139.45	50,900
Switzerland	Geneva	194.25	70,900
Switzerland	Zurich	107.45	39,219
Switzerland	All cities other than Bern, Geneva and Zurich.	90.14	32,900
Taiwan	Taipei	122.42	44,685
Thailand	Bangkok	100.27	36,600
Turkey	Ankara	89.04	32,500
Turkey	Elmadag	89.04	32,500
Turkey	Izmir-Cigli	86.58	31,600
Turkey	Manzarali	89.04	32,500
Turkey	Yamanlar	86.58	31,600
Ukraine	Kiev	89.98	32,844
United Arab Emirates	Abu Dhabi	84.07	30,687
United Arab Emirates	Dubai	116.31	42,452
United Kingdom	Basingstoke	112.60	41,099
United Kingdom	Bath	112.33	41,000
United Kingdom	Bracknell	170.14	62,100
United Kingdom	Bristol	106.03	38,700
United Kingdom	Cambridge	117.81	43,000
United Kingdom	Caversham	202.19	73,800
United Kingdom	Cheltenham	128.22	46,800
United Kingdon	Chicksands	72.60	26,500
United Kingdom	Croughton	105.75	38,600
United Kingdom	Fairford	108.77	39,700
United Kingdom	Farnborough	141.92	51,800
United Kingdom	Felixstowe	123.29	45,000
United Kingdom	Gibraltar	122.24	44,616
United Kingdom	Harrogate	119.18	43,500
United Kingdom	High Wycombe	170.14	62,100
United Kingdom	Kemble	108.77	39,700
United Kingdom	Lakenheath	150.96	55,100
United Kingdom	Liverpool	106.30	38,800
United Kingdom	London	213.15	77,800
United Kingdom	Loudwater	143.84	52,500

Country	Location	Limitation on Housing Expenses (daily)	Limitation on Housing Expenses (full year)
United Kingdom	Menwith Hill	119.18	43,500
United Kingdom	Mildenhall	150.96	55,100
United Kingdom	Oxfordshire	105.75	38,600
United Kingdom	Plymouth	105.75	38,600
United Kingdom	Portsmouth	105.75	38,600
United Kingdom	Reading	170.14	62,100
United Kingdom	Rochester	109.32	39,900
United Kingdom	Southampton	121.10	44,200
United Kingdom	Surrey	132.61	48,402
United Kingdom	Waterbeach	120.27	43,900
United Kingdon	West Byfleet	72.33	26,400
United Kingdom	Wiltshire	113.97	41,600
United Kingdom	All cities other than Basingstoke, Bath, Belfast, Birmingham Bracknell, Bristol, Brough, Bude, Cambridge, Caversham, Chelmsford, Cheltenham, Chicksands, Croughton, Dunstable, Edinburgh, Edzell, Fairford, Farnborough, Felixstowe, Ft. Halstead, Glenrothes, Greenham Common, Harrogate, High Wycombe, Hythe, Kemble, Lakenheath, Liverpool, London, Loudwater, Menwith Hill, Mildenhall, Nottingham, Oxfordshire, Plymouth, Portsmouth, Reading, Rochester, Southampton, Surrey, Waterbeach, Welford, West Byfleet, and Wiltshire.	104.93	38,300
Venezuela	Caracas	156.16	57,000
Vietnam	Hanoi	128.22	46,800

EFFECTIVE DATE

This notice is effective for taxable years beginning on or after January 1, 2007.

DRAFTING INFORMATION

The principal author of this notice is Paul J. Carlino of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Carlino at (202) 622–3840 (not a toll-free call).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also: Part I, Sections 704(c); 1.704–3(e)(3).)

Rev. Proc. 2007–59

SECTION 1. PURPOSE

The purpose of this revenue procedure is to permit certain partnerships to aggregate gains and losses from an expanded class of qualified financial assets for purposes of making reverse section 704(c) allocations under § 1.704–3(e)(3).

SECTION 2. BACKGROUND

01. To prevent the shifting of tax consequences among partners with respect to precontribution gain or loss, section 704(c) requires partnerships to allocate income, gain, loss, and deductions with respect to property contributed by a partner so as to take into account any variation between the adjusted tax basis of the property and

its fair market value at the time of the contribution. These allocations must be made using a reasonable method that is consistent with the purpose of section 704(c). Section 1.704–3(a)(6) provides that similar rules apply to differences between book value and tax basis that are created by a revaluation of partnership assets pursuant to § 1.704–1(b)(2)(iv)(f) (reverse section 704(c) allocations).

02. Section 1.704–3(a)(2) provides that section 704(c) allocations are generally made on a property-by-property basis. Therefore, built-in gains and losses from different items of contributed or revalued property generally cannot be aggregated.

03. Section 1.704–3(e)(3) provides a special rule that allows securities partnerships to make reverse section 704(c) allocations on an aggregate basis. Specifically, § 1.704–3(e)(3)(i) provides that, for purposes of making reverse section 704(c) allocations, a securities partnership may aggregate built-in gains and losses from qualified financial assets using any reasonable approach that is consistent with the purpose of section 704(c).

04. Section 1.704–3(e)(3)(iii)(A) provides that a partnership is a securities partnership if the partnership is either a management company or an investment partnership, and the partnership makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership).

05. Section 1.704–3(e)(3)(iii)(B)(1) provides that a partnership is a management company if it is registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended (15 U.S.C. 80a).

06. Section 1.704–3(e)(3)(iii)(B)(2) provides that a partnership is an investment partnership if (1) on the date of each capital account restatement, the partnership holds qualified financial assets that constitute at least 90 percent of the fair market value of the partnership's non-cash assets; and (2) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under § 1.704–3(e)(3), to make revaluations at least annually.

07. Section 1.704–3(e)(3)(ii)(A) provides that a qualified financial asset is any personal property (including stock) that is actively traded. Actively traded means actively traded as defined in § 1.1092(d)–1 (defining actively traded property for purposes of the straddle rules). In addition, under § 1.704–3(e)(3)(ii)(B), for management companies, qualified financial assets also include the following, even if not actively traded: shares of stock in a corporation; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, any security, currency, or commodity, including any option, forward or futures contract, or short position; or any similar financial instrument.

08. Sections 1.704–3(e)(3)(iv) and (v) describe two methods of making reverse section 704(c) allocations on an aggregate basis that are generally reasonable, the partial netting and the full netting approaches, respectively.

09. Section 1.704–3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

10. Section 1.704–3(e)(4) provides in relevant part that the Commissioner may, by published guidance or by letter ruling, permit: (1) aggregation of properties other than assets described in paragraphs (e)(2) and (e)(3) of § 1.704–3; (2) partnerships other than securities partnerships to aggregate gain and loss from qualified financial assets; and (3) aggregation of qualified financial assets for purposes of making section 704(c) allocations in the same manner as that described in paragraph (e)(3) of § 1.704–3.

SECTION 3. DEFINITIONS

01. *Qualified Partnerships.* For purposes of this revenue procedure, a partnership is a Qualified Partnership if it satisfies the following requirements: (1) the partnership makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership); (2) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under this revenue procedure, to make revaluations of qualified financial assets at least four times annually; (3) on the date of each capital account restatement during the taxable year, the partnership holds qualified financial assets that constitute at least 90 percent of the partnership's non-cash assets; (4) the partnership reasonably expects, as of the first day of each taxable year for which the partnership seeks to aggregate under this revenue procedure, that the partnership (a) will have at least 10 unrelated partners at all times during the taxable year; and (b) will make at least 200 trades of qualified financial assets during the taxable year, the aggregate value of which will comprise at least 50% of the book value of the partnership's assets (including cash) as of the first day of the taxable year; and (5) the application of the aggregation method to reverse section 704(c) allocations under this revenue procedure is not made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. For purposes of this paragraph, partners are treated as related if they are related within the meaning of sections 267(b) or 707(b).

02. *Qualified financial assets.* Solely for purposes of this revenue procedure, qualified financial assets are (1) those assets described in § 1.704–3(e)(3)(ii)(A) and (B); (2) any interest in a partnership that is traded on an established securities market or readily tradable on a secondary market or the substantial equivalent thereof within the meaning of § 1.7704–1(c); and (3) any interest owned by the partnership (the upper-tier partnership) in a partnership (the lower-tier partnership) that represents it is a securities partnership or a Qualified Partnership, provided that such interest is (i) less than 10 percent of the capital and profits of the lower-tier partnership and that the upper-tier partnership does not actively or

materially participate in the management or operations of the lower-tier partnership; and (ii) less than 5 percent of the total book value of the upper-tier partnership's assets (including cash) as of the first day of the taxable year.

SECTION 4. APPLICATION

01. *Automatic permission to aggregate qualified financial assets.* Permission is hereby granted to any Qualified Partnership as defined in this revenue procedure to aggregate built-in gains and losses from qualified financial assets for purposes of making reverse section 704(c) allocations under § 1.704–3(e)(3). Pursuant to § 1.704–3(e)(3)(i), once a partnership adopts an aggregate approach under this revenue procedure, that partnership must apply the same aggregate approach to all of its qualified financial assets for all taxable years in which the partnership qualifies as a Qualified Partnership. However, a partnership may choose not to aggregate all of the partnership's qualified financial assets provided that such qualified assets do not exceed in the aggregate 30 percent of the book value of the partnership's non-cash assets at the time any such qualified financial assets is acquired.

02. *Subsequent failure to qualify as a Qualified Partnership.* A Qualified Partnership that adopts an aggregate approach under this revenue procedure and subsequently fails to qualify as a Qualified Partnership must make reverse section 704(c) allocations on an asset-by-asset basis after the date of disqualification. The partnership, however, is not required to disaggregate the book gain or book loss from qualified asset revaluations before the date of disqualification when making reverse section 704(c) allocations on or after the date of disqualification.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning on or after October 1, 2007. However, taxpayers may apply this revenue procedure to taxable years beginning after December 31, 2005.

SECTION 6. REQUEST FOR COMMENTS

.01 *Comments Requested.* The Treasury and IRS request comments on the appropriateness of the factors used to define Qualified Partnerships and qualified financial assets. Additionally, comments are requested on whether additional factors should be considered in defining Qualified Partnerships and qualified financial assets. The Treasury and the IRS also request comments as to whether additional guidance regarding the aggregation of qualified financial assets for purposes of making reverse section 704(c) allocations is appropriate or necessary.

.02 *Submission of Comments.* Written comments may be submitted to the Office of Associate Chief Counsel (Passthroughs & Special Industries), Attention: Jonathan E. Cornwell (Revenue Procedure 2007–59), CC:PSI:B01, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to *notice.comments@irscounsel.treas.gov*. Please include "Revenue Procedure 2007–59" in the subject line of any electronic communications. Comments will be available for public inspection and copying.

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Jonathan E. Cornwell and Steven A. Schmoll of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Mr. Cornwell or Mr. Schmoll at (202) 622–3050 (not a toll-free call).

Section 807.—Rules for Certain Reserves
(Also §§ 805, 812, 832.)

Rev. Proc. 2007–61

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which an insurance company subject to tax under subchapter L of the Internal Revenue Code is not required to take into account any portion of the increase for the taxable year in policy cash values of life insurance contracts described in § 264(f)(4)(A) (I-COLI Contracts) for purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5).

SECTION 2. BACKGROUND

.01 *Insurance company proration rules.* (1) To clearly reflect income, an insurance company is allowed to deduct increases in certain insurance reserves reflecting the company's obligations to policyholders. Like other taxpayers, an insurance company may receive tax-favored income, such as tax-exempt interest, intercorporate dividends, and the inside build-up under life insurance contracts. Because a portion of the reserve increase can be viewed as funded by tax-favored income, the insurance company proration rules require that tax-favored income be prorated between the insurance company and its policyholders. *See* §§ 807(a) and (b) (requiring that a life insurance company's deductible reserves be reduced by the "policyholders' share" of certain tax-favored income) and § 832(b)(5)(B) (requiring that a property and casualty insurance company's deductible additions to reserves be reduced by 15 percent of tax-favored income). *See also* § 805(a)(4) (generally limiting a life insurance company's deduction for dividends received to the "company's share" of the dividends); § 812 (setting forth the methodology for determining the company's share and the policyholder's share).

(2) Prior to 1997, the tax-favored investment income items taken into account under the insurance company proration rules were tax-exempt interest and intercorporate dividends. In the Taxpayer Relief Act of 1997, 1997–4 C.B. (Vol. 1) 165–69 ("1997 Act"), Congress amended §§ 807(a)(2), 807(b)(1), 805(a)(4), 812(d)(1), and 832(b)(5) to take into account "the increase for the taxable year in policy cash values . . . of life insurance policies and annuity and endowment *contracts to which section 264(f) applies*." (Emphasis added.) *See* § 1084(b) of the 1997 Act. The legislative history explained:

> [T]he rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to take into account the increase in the cash values

of life insurance policies or annuity or endowment contracts held by insurance companies.

H. R. Rep. No. 105–220, 105th Cong., 1st Sess. 588 (1997), 1997–4 (Vol. 2) C.B. 2058.

.02 *Contracts to which § 264(f) applies.* The IRS and the Treasury Department have become aware of questions concerning the interpretation of the phrase "contracts to which § 264(f) applies." For example, it may be argued that § 264(f) does not "apply" to contracts described in § 264(f)(4)(A) (*i.e.*, contracts covering 20-percent owners, officers, directors and employees) because those contracts are excepted from the disallowance rule of § 264(f)(1). Alternatively, it may be argued that the § 264(f)(4)(A) exception applies only for purposes of the disallowance rule of § 264(f)(1) and that other provisions of § 264(f) continue to "apply" to contracts covering 20-percent owners, officers, directors and employees. *See, e.g.*, § 264(f)(4)(C).

SECTION 3. SCOPE

This revenue procedure applies to I-COLI Contracts covering no more than 35 percent of the total aggregate number of the individuals described in § 264(f)(4)(A) at any time during the taxable year.

SECTION 4. SAFE HARBOR

For purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5), an insurance company is not required to take into account any portion of the increase for the taxable year in the policy cash values (within the meaning of section 805(a)(4)) of I-COLI contracts to which this revenue procedure applies pending the publication of additional guidance. Arrangements involving such contracts, however, remain subject to challenge by the IRS under other provisions of the tax law, including judicial doctrines such as the business purpose doctrine.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective September 11, 2007. If, in response to comments, additional guidance is published interpreting the phrase "contracts to which section 264(f) applies," such guidance will apply prospectively.

SECTION 6. REQUEST FOR COMMENTS

.01 Comments are requested concerning the need for additional guidance in this area. Specifically, comments are requested regarding the existence of any non-tax regulatory rules or other requirements that limit an insurance company's ability to invest in I-COLI Contracts and the effect of any experience rating, inter-insurance, reciprocal, or reinsurance arrangement on transactions involving I-COLI Contracts. In addition, the IRS would welcome comments on the operation of arrangements involving I-COLI Contracts.

.02 Comments should be submitted by December 31, 2007. Comments may be submitted by mail addressed to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, Attn. CC:PA:LPD:PR (Rev. Proc. 2007–61), Room 5205; by hand delivery (Monday through Friday between the hours of 8:00 a.m. through 4:00 p.m.) addressed to: Courier's Desk, Internal Revenue Service, Attn.: CC:PA:LPD:PR (Rev. Proc. 2007–61), Room 5205, 1111 Constitution Avenue, NW, Washington, DC 20224; or by email addressed to: *Notice.Comments@irscounsel.treas.gov.* Commentators should include the identification number of the publication (Rev. Proc. 2007–61) in both the email subject line and the body of the comment. All materials submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Stephen D. Hooe and John E. Glover of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Messrs. Hooe or Glover (202) 622–3900 (not a toll-free call).

Part IV. Items of General Interest

Exclusions From Gross Income of Foreign Corporations; Correction

Announcement 2007–79

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains corrections to notice of proposed rulemaking by cross-reference to temporary regulations (REG–138707–06, 2007–32 I.R.B. 342) that were published in the **Federal Register** on Monday, June 25, 2007 (72 FR 34650) modifying final regulations issued under section 883(a) and (c) of the Internal Revenue Code, relating to income derived by foreign corporations from the international operation of ships or aircraft.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking by cross-reference to temporary regulations that are the subject of this correction are under section 883 (a) and (c) of the Internal Revenue Code.

Need for Correction

As published, notice of proposed rulemaking by cross-reference to temporary regulations (REG–138707–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the proposed regulations (REG–138707–06), which was the subject of FR Doc. E7–12037, is corrected as follows:

1. On page 34650, column 2, in the preamble, under the paragraph heading "*Paperwork Reduction Act*", line 1 of the fourth paragraph, the language "Whether the proposed collection of" is corrected to read "Whether the proposed collections of".

2. On page 34650, column 2, in the preamble, under the paragraph heading "*Paperwork Reduction Act*", line 2 of the fifth paragraph, the language "associated with the proposed collection" is corrected to read "associated with the proposed collections".

3. On page 34651, column 1, in the preamble, under the paragraph heading "*Comments and Public Hearing*", line 7, the language "and Treasury Department specifically" is corrected to read "and the Treasury Department specifically".

4. On page 34651, column 2, in the preamble, under the paragraph heading "*Drafting Information*", line 5, the language "personnel from the IRS and Treasury" is corrected to read "personnel from the IRS and the Treasury".

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2007, 72 F.R. 45199)

Foundations Status of Certain Organizations

Announcement 2007–82

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

21st Century Inventions, Inc., St. Louis, MO
39 East, Inc., Newport News, VA
99 Wayz 2 Win Foundation, Inc., Atlanta, GA
A1 Credit Counseling, Inc., Fort Smith, AR
Academy of Martial Arts Foundation, Inc., Scarsdale, NY
Act Today Foundation, Las Vegas, NV
ADCO Development Corporation, Commerce City, CO
Advocates for Better Health, Inc., San Diego, CA
African American Free Loan Corp., Cleveland Heights, OH
Afro Charity, Inc., St. Paul, MN
AJ's Helping Hand, Lansing, MI
Alferdaws Islamic Center, Oakhurst, NJ
All Neighborhood Group Home, Inc., Jakin, GA
Allen-Lee Community Development Corporation, Columbus, OH
Alpha Gardens Community Development Corporation, Burgaw, NC
Alta Housing Corporation, Granbury, TX
American-Russian Education Assc., Inc., Scarsdale, NY
American Tae Kwon Do Foundation, Sherwood, OR
Angels International, Inc., Rockville, MD
Animal Advocacy and Relief Foundation, Encino, CA
Arizona Children First Shelter, Inc., Chandler, AZ
Artemis, Inc., Santa Fe, NM
ASJ, Inc., Hartford, CT
Assist by Knight, Inc., Philadelphia, PA
Autism Family Services of New Jersey, Inc., Trenton, NJ
B & H Financial Educators, Inc., Arvada, CO
Barnabas Bar Petra, Inc., Fayetteville, NC
Baseball in Africa, Inc., Shrewsbury, MA
Basketball Services Unlimited, Houston, TX
Black Heritage Rider, Inc., Piscataway, NJ
Boundless Development Corporation, Memphis, TN
Brazilian Arts Foundation, West Hollywood, CA

Building Young Leaders, Inc., Tulsa, OK
California Street Performers Association, Richmond, CA
Call Kyle, Inc., Hamilton Square, NJ
Castle Center, Inc., Hazelton, PA
Centro De Restauracion Jesus Manantial De Vida, Inc., Manati, PR
Challenging Minds, Carson, CA
Challenging the Arts, North Richland Hills, TX
Changing Lives at Home, Inc., Baltimore, MD
Charity Horse Adoption & Rescue Mission, Tomball, TX
Charlene's Turtle Sanctuary, Carrollton, TX
Cherish the Child Academy, Hackettstown, NJ
Cherokee Heights Community Development Corporation, Macon, GA
Child Safety Exchange, Torrance, CA
Childrens of the Light Academy, Wichita, KS
Christian Education Network, Inc., Lexington, KY
Christian Life Services, Inc., Philadelphia, PA
Christopher's Guests, Pittsburgh, PA
Chosen Generation, Fort Myers, FL
Church of the Simple Faith, Inc., Aubrey, TX
Citizens for Santo, Inc., Santo, TX
Coalition of Multi Ethnic Partnership and Support Services B, Plainview, NY
Coccon, Inc., Charleston, WV
Come Back to Eden, Inc., Gresham, OR
Community Counseling Services of North Carolina, Wilmington, NC
Community Energy Foundation, Tyler, TX
Community Housing Administration, Columbia, SC
Community Transitional Services and Resources, Los Angeles, CA
Community Voices in Action, Inc., Beaumont, TX
Connecticut Habilitation Centers, Colchester, CT
Connie and Priscilla Mack Foundation, Washington, DC
Covenant Medical Transporters, Inc., Birmingham, AL
Cowboys for Kids, Inc., Rhinebeck, NY
Creating Academic and Social Excellence Youth Development Program, Inc., Cleveland, OH
Creative Biomedical Research Institute, Philadelphia, PA
Crime Victims Advocacy Council, Lansing, MI
Crisis Counseling Center, Bakersfield, CA
Cunningham Lifesafety Education Center, Inc., Denver, CO
Current Elijah Ministries, Inc., The Woodlands, TX
Cyber Anthropology, Chevy Chase, MD
Cyber-Sight Foundation, Inc., Indianapolis, IN
D. R. Johnson Ministries, Centennial, CO
Dare to be Different of the Bay Area, Alameda, CA
Design Workshop Foundation, Aspen, CO
Designer Sewing Tech Center, Chicago, IL
Dewdrop Foundation, Inc., Mableton, GA
Divine Works, Inc., Tallahassee, FL
DKY Developers Association, Mokena, IL
Downtown Miamisburg, Inc., Miamisburg, OH
End Times Storm Ministries, Inc., Oklahoma City, OK
Energy Master Planning Institute, Inc., Silver Spring, MD
Estate and Wealth Strategies Institute at Michigan State University, Sarasota, FL
Evans Christian Learning Center, Inc., Columbus, MS
Evening of Prayer CEDC, Charleston, SC
Excel Youth Foundation, Irwindale, CA
Exsousia Ministries, Inc., Tulsa, OK
Fairview Community Development Corporation, Inc., Birmingham, AL
Faithful Women of God—Paws Octave, Elkton, MD
Family Service Organization, New York, NY
Family Support Center of New Jersey, Inc., Trenton, NJ
First Step Transitional Living Foundation, Los Angeles, CA
Foundation for Evidence-Based Medicine Education, Orange, CA
Foxmore Care, Inc., Corona, NY
Franklin Concept Group, Inc., Philadelphia, PA
Free for All Outreach Mission, Inc., Newton, GA
Freedom West Development Corporation, Rockford, IL
Friends of Compton Creek, Compton, CA
Friends of River Park, Inc., Ellijay, GA
Friends of the Mohegans, Inc., Greenfield Pk, NY
G F F Community Development Corporation, Inc., Kalamazoo, MI
Game Conservation International, Fort Worth, TX
Genesis Full Life, San Antonio, TX
George Graff Westchester-Putman Building Trades Scholarship Fund, Elmsford, NY
Gerry and Franca Mulligan Foundation, Inc., Westport, CT
Get on the Bus of Christ, Inc., Beaumont, TX
Global Relief Assistance, Inc., Beltsville, MD
Glory To God Mission, La Crescenta, CA
Go Community Organization, Inc., Chicago, IL
Golden Gate, Lake City, SC
Grace & Mercy Christian Shelter, Woodville, MS
Grace Foundation, Langley, WA
GracePoint America, Inc., Norcross, GA
Greater Bethel Development Corporation, Charlotte, NC
Greater St. Paul Educational Center, Port Allen, LA
Greater Works, Inc., Atlanta, GA
Green Door, Inc., Miami, FL
Greenwise Alliance, Inc., Annapolis, MD
Guided Endeavors, Inc., Mount Vernon, NY
Gunga Coleman-Helen Hunter Centers for Success, West Hills, CA
Haggai Community Services, Culver City, CA
Haitian American Professionals Coalition, Inc., Fort Lauderdale, FL
Hammond Heights, Inc., North Augusta, SC
Hamptons Artillery, Centre Hall, PA
Harold B. Rhodes Music Foundation, Pasadena, CA
Heavens Angel Paws, Lakewood, CA
Helping Animals Lives Organization, Kerens, TX
Helping Hand Mission, Chicago, IL
Helpnow, Inc., Frederick, MD
Historic Royal Palaces, Inc., Washington, DC
Home Away From Home II, Little Rock, AR
Homeward Bound Outreach, Stuttgart, AR
Hope Factory, Inc., Smithfield, RI
Hour of Restoration & Community Development Corporation, Cheneyville, LA
IFF Foundation for Philanthropy, Irvine, CA
Iluminadas Performing Arts School and Educational Services, Inc., St. Paul, MN

Imua Transit Services, Honolulu, HI
In Depth Ministries, Inc., Houston, TX
In Line With the Word Ministries, Inc., Tallahassee, FL
Information Integrity Foundation, Naperville, IL
Institute for At Risk Children, Alexandria, VA
Institute for Research on Learning Technology Visions, Inc., Menands, NY
Institute for the Healing Heart Foundation, Houston, TX
Jackson Community Center for the Deaf, Jackson, MS
Jackson Youth League, Jackson, MO
Jeto Productions, Inc., Pine Bluff, AR
Jetta's Track Club, Inc., Bergensfield, NJ
Joetta Clark-Diggs Sports Foundation, Inc., Hillsborough, NJ
John B. McLendon Foundation, Inc., Roswell, GA
JRT Productions, Inc., Starruca, PA
Kealakehe Ahupua'a 2020, Kailua-Kona, HI
Khal-Khai, Inc., Warrensville Heights, OH
Khocolate Keepsakes II Childrens Literacy Museum, Irving, TX
Kids 101, Inc., Eugene, OR
Kingdom Foundation, Somerset, KY
Kingdom Kids Child Placing Agency, Lancaster, TX
Konkel Scholarship Foundation, Inc., Walsh, CO
Legal Clinic and Counseling Center, Inc., Alexandria, LA
Lifestyle Changes, Inc., Missouri City, TX
Lighthouse Core Development Corporation, South Orange, NJ
Lithonia Development Corp., Inc., Lithonia, GA
Little Rock Community Development Corp., Selma, AL
Logansport Health Education Center, Inc., Logansport, IN
London Bridges Kids Foundation, Powder Springs, GA
M B International Refugee Center, Orlando, FL
Make it Public, Inc., San Francisco, CA
Making a Difference in the Community, Inc., Atlanta, GA
Medieval Properties, Incorporated, Lakewood, CO
Michigan Dominators Softball Club, Clinton, MI
Michigan National Organization for Women Foundation, Inc., East Lansing, MI
Millennium Hills Development Group, Inc., Murfreesboro, TN
Mind Star, Inc., San Diego, CA
Minnesota AG Network, Mahtomedi, MN
Morenci Area Community Center, Morenci, MI
Mother Nature's Axle-Economic Development and Support, Milwaukee, WI
Motivational Centers, Brooklyn, NY
Mt. Olive Housing, Inc., Myrtle Beach, SC
Museum of Pop Culture, Redwood City, CA
MYGPA.ORG, Atlanta, GA
NAALA National Association for the Advancement of Living Artists, Houston, TX
National 12 Rounds Mentoring Program, Inc., Bowie, MD
National Committee for History of Art, Inc., Los Angeles, CA
Natural Health Research Institute, San Diego, CA
Natures Creations, Inc., Borden, IN
Neily Peach Happy Home, Willingboro, NJ
New City Community Development Corporation, New Orleans, LA
New Covenant Christian Outreach, Kemo, MO
New Covenant Community Education Corporation, Dallas, TX
Next Chance Recovery Center of Atlanta, Inc., Atlanta, GA
Nita's Private Outreach Home, Legrange, CA
North Florence Ministries of the Holy Spirit, Inc., Florence, SC
NP Leadership Collaborative, Birmingham, MI
Nu-Light Economic Development Corporation, Houston, TX
Oakland Wrestling Club, Oakland, NJ
Oasis of Hope Ministries, Jefferson, TX
One Spirit One World, Westlake Village, CA
Operation Educate, Highland Park, MI
Optimal Health Quest, Inc., Baltimore, MD
Orphan Charity, Costa Mesa, CA
Our Children's Hope, Inc., Flanders, NJ
Outreach International, Inc., Branford, CT
Pagedale Community Association, St. Louis, MO
Pairadocs Community Development Corp., Dallas, TX
Panhandle Sports Medicine Association, Amarillo, TX
Patterson/Horton Retreat Center & Youth Home, Franklinton, LA
Peace Patrol Program, Inc., Missouri City, TX
Pearls of Wisdom, Yarnell, AZ
Peer Plus Education & Training Advocates, Chicago, IL
People Helping People Help Themselves, Salt Lake City, UT
People on the Rise Community Economic Development Corporation, Plainfield, NJ
People With Pride, Incorporated, Ontario, CA
P H Smith, Houston, TX
Pleasant Grove Community Development Service Center, Inc., Fairfield, AL
Positive Focus Foundation, Inc., Washington, DC
Pride of Wisconsin Farms, Inc., Elroy, WI
Progressive Care Systems, Inc., St. Clair Shores, MI
Projects for Positive Change, Roseville, CA
Radiology Research Fund, Eugene, OR
RE-1J Foundation, Inc., Holyoke, CO
Recognizing All Cultures Equally, Inc., Portsmouth, VA
Recovering Pharmacists Network of Florida, Inc., Longwood, FL
Regional Collection Education Foundation, Inc., Marietta, OH
Restore Trust, Longville, LA
Rosslyn Academy International, Inc., Trout Run, PA
Ryan Stoller Fund for Acute Head Trauma Patients, Inc., Perrysburg, OH
SAAF Group, Inc., Birmingham, AL
Safety First for Kids, Detroit, MI
San Diego Foundation for Recovery, San Diego, CA
Sapintia Culture and Education Foundation, Bellevue, WA
Save The Rain Forests Foundation, Las Vegas, NV
Saving Noahs Generation, Inc., Kansas City, MO
Seafaring College, Inc., Sarasota, FL
Second Chance for Teens, Incorporated, Baltimore, MD
Seeds of Salvation Christian Ministry, Elk Grove, CA
Service to Mankind Foundation, Inc., Jasper, GA

Shango, Inc., Center for the Study of African American Art and Culture, Dayton, OH
Skills Development for Self Reliance, Marietta, GA
South Central Training & Research Consortium, Los Angeles, CA
Sports Resource Program, Rancho Palos Verdes, CA
Springfield Tigers, Inc., Springfield, IL
Starfestival, Lexington, MA
Strong Women of God, Inc., Baldwin, FL
Suburban Chamber of Commerce Foundation, Willow Grove, PA
Support Teen Outreach Program, Doylestown, PA
Sword of Splendor International Ministry, Inc., Bronx, NY
Tarae Simone Family Services, Inc., Bellflower, CA
TCR Children's Services, East Palo Alto, CA
Teen Action Program, Los Angeles, CA
Texas Prostate Cancer Coalition, Houston, TX
TJ Family Enterprise, Inc., Mokena, IL
To Kindle Spirit A Not For Profit Corporation, Annandale, VA
Transcom Community Development Corp., Houston, TX
Tree of Life Economic Development, Inc., Birmingham, AL
Trost Living Charities, Orlando, FL
TS August, Reston, VA
Turning Point Educational Experience, Spring Hill, TN
Tyler County Ministers Union, Chester, TX
Union Valley Outreach Ministries, Inc., Wynne, AR
United Christian Children's Fund, Tukwila, WA
Venture Capital & Loan, Inc., Mount Pleasant, MI
Victory Resource Institute, Springfield, MO
Vocational Education and Careers Centers, Riverdale, GA
WCI Educational Foundation, Asheville, NC
Westerville Cats Baseball Club, Cumberland, MD
Will Power-Power, Houston, TX
William and Sylvia Development Corporation, Philadelphia, PA
Willis Center for Personal Growth and Development, Incorporated, Inglewood, CA
Women in Transition, Inc., Baltimore, MD
Work Life Initiatives, Inc., West Chester, PA
Working Together as One Production, Humble, TX
Workshops Unlimited, Inc., Royal Palm Beach, FL
Zapotlan Project, Inc., Argyle, TX
Zara' Ministries, Belleville, IL
Zoe Group Outreach, Norcross, GA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Exclusions From Gross Income of Foreign Corporations; Correction

Announcement 2007–83

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final and temporary regulations (T.D. 9332, 2007–32 I.R.B. 300) that were published in the **Federal Register** on Monday, June 25, 2007 (72 FR 34600) relating to the exclusion from gross income of income derived by certain foreign corporations engaged in the international operation of ships or aircraft.

DATES: The correction is effective August 13, 2007.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final and temporary regulations that are the subject of this correction are under section 883 of the Internal Revenue Code.

Need for Correction

As published, final and temporary regulations (T.D. 9332) contain an error that may prove to be misleading and is in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendment:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.883–1 is amended by revising paragraph (h)(3) to read as follows:

§ 1.883–1 Exclusion of income from the international operation of ships or aircraft.

* * * * *

(h) * * *

(3) For further guidance, see the entry for § 1.883–1T(h)(3).

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2007, 72 F.R. 45159)

Payout Requirements for Type III Supporting Organizations That are Not Functionally Integrated

Announcement 2007–87

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document describes rules that the Treasury Department and the IRS anticipate proposing, in a notice of proposed rulemaking, regarding the payout requirements for Type III supporting organizations that are not functionally integrated, the criteria for determining whether a Type III supporting organization is functionally integrated, the modified requirements for Type III supporting organizations that are organized as trusts, and the requirements regarding the type of information a Type III supporting organization must provide to its supported organization(s) to demonstrate that it is responsive to its supported organization(s). Sections 1241 and 1243 of the Pension Protection Act of 2006 amended the law with respect to Type III supporting organizations prompting a need to revise the Treasury Regulations regarding the four matters mentioned above. These new requirements and criteria would apply to Type III supporting organizations as defined under sections 509(a)(3)(B)(iii) and 4943(f)(5) of the Internal Revenue Code (Code). This document also invites comments from the public regarding the proposed payout requirement and the proposed criteria for qualifying as functionally integrated. All materials submitted will be available for public inspection and copying.

DATES: Written or electronic comments must be submitted by October 31, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–155929–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–155929–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C., or sent electronically via the Federal eRulemaking Portal at http://*www.regulations.gov/* (IRS REG–155929–06).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Richard A. Hurst at (202) 622–2949 (TDD Telephone) and his e-mail address is *Richard.A.Hurst@irscounsel.treas.gov*; concerning the proposed rules, Philip T. Hackney or Michael B. Blumenfeld at (202) 622–6070 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (PPA), amended the requirements that an organization exempt from tax under section 501(c)(3) of the Code must meet to qualify as a Type III supporting organization under section 509(a)(3) of the Code. This advanced notice of proposed rulemaking describes the rules that the Treasury Department and the IRS expect to propose to implement the new qualification requirements for Type III supporting organizations enacted by Congress and solicits comments from the public.

Public Charities versus Private Foundations

Under section 509(a), an organization described in section 501(c)(3) is a private foundation unless it meets the requirements of section 509(a)(1), (2), (3), or (4). Organizations described in section 501(c)(3) that meet the requirements of section 509(a)(1), (2), (3), or (4) are referred to as public charities.

Private foundations, which are generally divided into two categories, operating and non-operating, depending on the type of activity in which the foundation engages, are subject to a different set of requirements than those applicable to public charities. Sections 4940 through 4948 impose various restrictions and excise taxes on private foundations along with their disqualified persons and foundation managers, that are generally not applicable to public charities. Furthermore, more stringent deduction limitations apply to contributions made to private non-operating foundations than apply to contributions to public charities. For example, under section 170(b)(1)(A), an individual who makes a cash contribution to a public charity may deduct up to fifty percent of his or her contribution base (a modified adjusted gross income amount) in the year of his or her contribution, while the same contribution to a private non-operating foundation would be limited to thirty percent of the individual's contribution base under section 170(b)(1)(B). In addition, deductions for contributions of certain appreciated property to a private non-operating foundation are limited to the contributor's basis in the property under section 170(e)(1)(A), while the same contribution to a public charity could result in a deduction based on the property's fair market value under section 170(e)(1)(B)(ii).

Supporting Organizations

Public charities that meet the requirements of section 509(a)(3) are known as supporting organizations. To be classified as a supporting organization, an organization must satisfy an organizational test, an operational test, a relationship test, and a disqualified person control test. The organizational and operational tests require that the organization be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to conduct the purposes of one or more publicly supported organizations described in section 509(a)(1) or (2). The relationship test requires that the organization be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. Finally, the disqualified person control test requires that the organization not be controlled directly or indirectly by certain disqualified persons.

Relationship Test

Treasury Regulation (Treas. Reg.) § 1.509(a)–4(f)(2) sets forth three structural or operational relationships a supporting organization is permitted to have with its supported organization(s). Each supporting organization must have one of the three types of relationships with the organization(s) it supports to be a supporting organization described in section 509(a)(3) of the Code. The purpose of the relationship requirement is to ensure that a supporting organization has a sufficiently close tie to one or more publicly supported organizations such that the supporting organization will be accountable to a broader public constituency.

A supporting organization that is operated, supervised or controlled by one or more publicly supported organizations is commonly known as a Type I supporting organization. The relationship a Type I supporting organization has with its supported organization(s) is comparable to that of a parent-subsidiary relationship. A supporting organization supervised or controlled in connection with one or more publicly supported organizations is commonly known as a Type II supporting organization. The relationship a Type II supporting organization has with its supported organization(s) is comparable to a brother-sister corporate relationship. A supporting organization that is operated in connection with one or more publicly supported organizations is commonly known as a Type III supporting organization.

Qualification Requirements for Type III Supporting Organizations Prior to Enactment of the Pension Protection Act

In general, Treas. Reg. § 1.509(a)–4(i)(1) requires an organization to meet a "responsiveness test" and an "integral part test" to satisfy the relationship requirement for a Type III supporting organization.

Responsiveness Test: General Rule. Treas. Reg. § 1.509(a)–4(i)(2)(i) provides that an organization is "considered to meet the 'responsiveness test' if the organization is responsive to the needs or demands of" its publicly supported organizations. Treas. Reg. § 1.509(a)–4(i)(2)(ii) provides that a supporting organization may demonstrate responsiveness to its publicly supported organization(s) if: (1)(a) one or more of its officers, directors, or trustees are elected or appointed by the officers, directors, trustees, or membership of its publicly supported organization(s), (b) one or more members of the governing bodies of its publicly supported organization(s) are also officers, directors, or trustees of, or hold other important offices in, the supporting organization, or (c) the officers, directors, or trustees of the supporting organization maintain a close, continuous working relationship with the officers, directors, or trustees of its publicly supported organization(s); and (2) by reason of such arrangement, the officers, directors, or trustees of its publicly supported organization(s) have a significant voice in the investment policies of the supporting organization, the timing and the manner of making grants, the selection of the grant recipients by the supporting organization, and otherwise directing the use of the income or assets of the supporting organization.

In addition, with respect to an organization that was supporting a publicly supported organization before November 20, 1970, Treas. Reg. § 1.509(a)–4(i)(1)(ii) provides that additional facts and circumstances, such as a historic and continuing relationship between the supporting organization and its supported organization(s), may be taken into account, in addition to the factors described in the general responsiveness test above, to establish compliance with the responsiveness test.

Responsiveness Test: Charitable Trusts. Before enactment of the PPA, one way of satisfying the responsiveness test, under Treas. Reg. § 1.509(a)–4(i)(2)(iii), required that (1) the supporting organization be a charitable trust under State law, (2) each publicly supported organization that the trust supports be named as a beneficiary under the charitable trust's governing instrument, and (3) each beneficiary organization have the power to enforce the trust and compel an accounting under State law. As described below, this method of satisfying the responsiveness test was effectively removed by the PPA.

Integral Part Test. Treas. Reg. § 1.509(a)–4(i)(3)(i) provides that a supporting organization is required to establish that "it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides." Treas. Reg. § 1.509(a)–4(i)(3)(ii) and (iii) sets forth two alternative ways to meet the integral part test. The first method is typically referred to as the "but for" test. In this advance notice of proposed rulemaking, the second method of meeting the integral part test will be referred to as the "attentiveness" test.

Integral Part Test, Alternative I: the "but for" test. Under Treas. Reg. § 1.509(a)–4(i)(3)(ii) the "but for" test is satisfied if "the activities engaged in [by the supporting organization] for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and, but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves."

Integral Part Test, Alternative II: the "attentiveness" test. The "attentiveness" test, under Treas. Reg. § 1.509(a)–4(i)(3)(iii), requires a supporting organization to (1) make payments of substantially all of its income to or for the use of one or more publicly supported organizations, (2) provide enough support to one or more publicly supported organizations to insure the attentiveness of such organizations to the operations of the supporting organization, and (3) pay a substantial amount of the total support of the supporting organization to those publicly supported organizations that meet the attentiveness requirement. Rev. Rul. 76–208, 1976–1 C.B. 161, (see § 601.601(d)(2) of this chapter), provides that the phrase "substantially all of its income" in Treas. Reg. § 1.509(a)–4(i)(3)(iii) means at least 85 percent of its adjusted net income.

PPA Amendments to Qualification Requirements for Type III Supporting Organizations

The PPA amended the qualification requirements for Type III supporting organizations, modifying both the integral part test and the responsiveness test.

Sections 1241 and 1243 of the PPA enacted Code sections 509(f) and 4943(f)(5).

These provisions define the term Type III supporting organization and distinguish between functionally integrated and non-functionally integrated Type III supporting organizations. These two new categories appear to reflect the distinction drawn in the Treasury Regulations between those organizations that meet the integral part test by meeting the "but for" test and those that meet the integral part test by meeting the "attentiveness" test.

In conformity with existing Treasury Regulations, new section 4943(f)(5)(A) defines a Type III supporting organization as a supporting organization that is operated in connection with one or more section 509(a)(1) or (2) organizations. New section 4943(f)(5)(B) defines a functionally integrated Type III supporting organization as a Type III supporting organization that is not required under regulations established by the Secretary to make payments to supported organizations due to the activities of the organization related to performing the functions of, or carrying out the purposes of, such supported organizations. Although this language appears similar to the "but for" prong of the integral part test, the Staff of the Joint Committee on Taxation in its technical explanation of the provision notes that there is "concern that the current regulatory standards for satisfying the integral part test not by reason of a payout [*i.e.*, the existing "but for" test] are not sufficiently stringent to ensure that there is a sufficient nexus between the supporting and supported organizations." See Staff of the Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX–38–06) at 360 n. 571, August 3, 2006 (Technical Explanation). In particular, the Technical Explanation states that in revising the Type III supporting organization regulations the Secretary "shall strengthen the standard for qualification as [a Type III supporting] organization that is not required to pay out." *Id.*

Section 1241(d)(1) of the PPA directed the Secretary to promulgate new regulations on the payments required by Type III supporting organizations that are not functionally integrated. Section 1241(d)(1) of the PPA provides that such regulations shall require non-functionally integrated Type III supporting organizations to make distributions of a "percentage of either income or assets to supported organizations (defined in new section 509(f)(3) of [the] Code) in order to ensure that a significant amount is paid" to their supported organizations. The Technical Explanation notes that there is concern that merely requiring a Type III supporting organization to pay out substantially all of its net income (as under the "attentiveness" prong of the integral part test) does not necessarily result in significant distributions to publicly supported organizations relative to the value of the assets held by the Type III supporting organization and "as compared to amounts paid out by nonoperating private foundations." See Technical Explanation at 360 n. 571.

Section 1241(c) of the PPA modified the responsiveness test as it applies to charitable trusts. Effectively, section 1241(c) provides that having each organization that the trust supports be a publicly supported organization named as a beneficiary under the trust's governing instrument and establishing that each beneficiary organization has the power to enforce the trust and compel an accounting is no longer sufficient to satisfy the responsiveness test as provided in Treas. Reg. § 1.509(a)–4(i)(2)(iii). The Technical Explanation states that a Type III supporting organization organized as a trust must now "establish to the satisfaction of the Secretary, that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization." Technical Explanation at 362. Under section 1241(e)(2)(A) of the PPA, trusts that operated in connection with a publicly supported organization on August 17, 2006, have until August 17, 2007 to satisfy the modified responsiveness test under Treas. Reg. 1.509(a)–4(i)(2)(ii). For other trusts, the provision was effective on August 17, 2006.

Finally, section 1241(b) added section 509(f)(1)(A), which contains another requirement for Type III supporting organizations. The provision requires a Type III supporting organization to provide each of its supported organizations with "such information as the Secretary may require to ensure that such organization is responsive to the needs or demands of the supported organization."

As described in this advanced notice of proposed rulemaking, the Treasury Department and the IRS intend to propose regulations that provide (1) the payout requirements for Type III supporting organizations that are not functionally integrated, (2) the criteria for determining whether a Type III supporting organization is functionally integrated, (3) the modified responsiveness test for Type III supporting organizations that are organized as charitable trusts, and (4) the type of information a Type III supporting organization will be required to provide to its supported organization(s) to demonstrate that it is responsive.

Explanation of Provisions

Summary of Proposed Criteria for Qualifying as a Type III Supporting Organization

The Treasury Department and the IRS expect that all Type III supporting organizations will be required to meet the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). In addition, it is expected that Type III supporting organizations that are functionally integrated will be required to meet: (A) the "but for" test in existing Treas. Reg. § 1.509(a)–4(i)(3)(ii); (B) an expenditure test that will resemble the qualifying distributions test for private operating foundations; and (C) an assets test that will resemble the alternative assets test for private operating foundations. Finally, it is expected that a Type III supporting organization that is not functionally integrated will be required to meet a payout requirement equal to the qualified distribution requirement of a private non-operating foundation. In addition, there will be a limit on the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support. These proposed criteria for qualifying as a Type III supporting organization will replace the integral part test in the existing regulations. These provisions are explained in more detail below.

Definition of Functionally Integrated Type III Supporting Organization and

the Applicability of Private Operating Foundation Rules

Private operating foundations under section 4942(j)(3) share strong similarities with Type III functionally integrated supporting organizations under section 4943(f)(5)(B) in that both are expected to be directly engaged in the active conduct of charitable activities rather than only making grants to, or for the use of, charitable organizations. The Code and Treasury Regulations provide extensive rules used to determine whether a private foundation is a private operating foundation. See section 4942(j)(3) and Treas. Reg. § 53.4942(b). The Treasury Department and the IRS believe that these rules provide a useful model for developing standards to determine whether a Type III supporting organization is functionally integrated, and that adoption of similar rules under section 4943(f)(5)(B) will further the Congressional purpose articulated in the Technical Explanation of strengthening the nexus between a functionally integrated Type III supporting organization and the publicly supported organization(s) it supports.

To qualify as a private operating foundation under section 4942(j)(3), an organization must satisfy a qualifying distributions test and one of three alternative tests described below. Under the qualifying distributions test, a private operating foundation must make qualifying distributions "directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated," equal to substantially all (at least 85 percent) of the lesser of its adjusted net income or its minimum investment return. Under section 4942(e)(1), the minimum investment return is equal to 5 percent of the excess of (A) the aggregate fair market value of all the foundation's assets other than those used (or held for use) directly in carrying out the organization's exempt purpose over (B) the acquisition indebtedness with respect to such assets. Under Treas. Reg. § 53.4942(b)–1(b)(1), a qualifying distribution directly for the active conduct of activities constituting the foundation's exempt purpose is a distribution that is used by the foundation itself to carry out its exempt activities rather than paid to other organizations to help them carry out their exempt activities.

In addition, a private operating foundation must meet one of three alternative tests: an assets test, an endowment test or a support test. The assets test, under section 4942(j)(3)(B)(i) and Treas. Reg. § 53.4942(b)–2(a), requires that substantially more than half (at least 65 percent) of the assets of an operating foundation must be devoted directly to the private operating foundation's exempt purpose activities, or to functionally related businesses (see section 4942(j)(4)), or both, or are stock of a corporation controlled by, and substantially all (at least 85 percent) of the assets of which are devoted to, the foundation. The endowment test, under Treas. Reg. § 53.4942(b)–2(b), requires a foundation to make qualifying distributions directly for the active conduct of its exempt activities in an amount not less than two thirds of its minimum investment return. The support test, under Treas. Reg. § 53.4942(b)–2(c), is satisfied if substantially all (85 percent) of a foundation's support (other than gross investment income) is normally received from the general public and from five or more exempt organizations that are not related to each other or the recipient foundation, if the foundation does not normally receive more than 25 percent of its support from any one such exempt organization; and if the foundation does not normally receive more than 50 percent of its support from gross investment income.

Description of the Proposed Functionally Integrated Test

The Treasury Department and the IRS anticipate that the proposed regulations will define the term functionally integrated Type III supporting organization as a Type III supporting organization that meets: (A) the "but for" test in existing Treas. Reg. § 1.509(a)–4(i)(3)(ii); (B) an expenditure test consistent with section 4942(j)(3)(A); and (C) an assets test consistent with section 4942(j)(3)(B)(i). It is expected that the expenditure test will require a functionally integrated Type III supporting organization to use substantially all of the lesser of (a) its adjusted net income or (b) five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of the supported organizations) directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The assets test will require the organization to devote at least 65 percent of the aggregate fair market value of all its assets directly for the active conduct of activities that directly further the exempt purposes of the organizations it supports. The Treasury Department and the IRS believe that requiring functionally integrated Type III supporting organizations to satisfy the expenditure and assets tests, in addition to the "but for" test, will be stronger than the existing integral part test and ensure a sufficient nexus between a supporting organization and the organization(s) it supports. These tests also will ensure that a sufficient amount is being dedicated directly to the active conduct of activities that further the exempt purposes of publicly supported organizations.

The term "adjusted net income" is expected to have substantially the same meaning as that term has in section 4942(f) and Treas. Reg. § 53.4942(a)–2(d). The valuation of assets is expected to be determined in a manner similar to the rules under section 4942(e)(2) and Treas. Reg. § 53.4942(a)–2(c)(4).

The Treasury Department and the IRS also intend that certain Type III supporting organizations that oversee or facilitate the operation of an integrated system that includes one or more charities and that may be unable to satisfy the "direct active conduct" and "directly further" requirements of the expenditure and assets tests, such as certain hospital systems, will be classified as functionally integrated in the proposed regulations if they satisfy the existing "but for" test.

The proposed regulations will not permit a functionally integrated Type III supporting organization to qualify as functionally integrated by using the endowment or support tests that are available to private operating foundations as alternatives to the proposed assets test. Because the endowment test is similar to the expenditure test, the Treasury Department and the IRS believe that the endowment test would not provide sufficient additional assurances of a tight nexus between a functionally integrated supporting organization and its supported organizations. Furthermore the support test, which focuses on sources of support received by a private foundation rather than on its activities, ap-

pears to be inapplicable to the functionally integrated concept. By requiring at least 65 percent of the value of all assets of each functionally integrated supporting organization to be devoted directly for the active conduct of the activities of its supported organizations, the proposed assets test is intended to ensure that the connection between the supporting and supported organizations is significant.

Payout Requirement for Type III Supporting Organizations that are not Functionally Integrated

In establishing a payout requirement for non-functionally integrated Type III supporting organizations, the Treasury Department and the IRS expect to follow the framework of the existing section 4942 qualifying distribution regulations applicable to private non-operating foundations. Private non-operating foundations have operated under these qualifying distribution regulations for many years. The Treasury Department and the IRS believe these rules are appropriate for Type III grant-making organizations, and would further the Congressional purpose articulated in the Technical Explanation of ensuring that, as compared to amounts paid out by private non-operating foundations, significant amounts are being paid to supported organizations even if the supporting organization's assets produce little or no income.

A private non-operating foundation is required under section 4942 to make certain qualifying distributions or pay an excise tax. A private non-operating foundation is generally liable for this excise tax under section 4942(a) and (b) if it does not make qualifying distributions each year equal to its minimum investment return. The minimum investment return is five percent of the aggregate fair market value of all the foundation's assets other than those used (or held for use) directly in carrying out the organization's exempt purpose over the acquisition indebtedness with respect to such assets. Qualifying distributions under section 4942(g) are generally those distributions (including reasonable and necessary administrative expenses) paid to accomplish charitable purposes.

Description of the Proposed Payout Rule

The Treasury Department and the IRS anticipate that the proposed regulations will (A) require a non-functionally integrated Type III supporting organization to meet a payout requirement and (B) limit the number of publicly supported organizations a non-functionally integrated Type III supporting organization may support.

The payout requirement will call for a Type III supporting organization that is not functionally integrated to distribute annually to or for the use of its supported organizations an amount equal to at least five percent of the aggregate fair market value of all its assets (other than assets that are used, or held for use, directly in supporting the charitable programs of its supported organizations). Additionally, the Treasury Department and the IRS are concerned that a supporting organization's relationship with and accountability to its supported organizations is diminished as the number of its supported organizations increases. Accordingly, except for organizations in existence on or before the date the regulations are proposed, it is expected that the proposed regulations will also provide that non-functionally integrated Type III supporting organizations will be limited to supporting no more than five publicly supported organizations. An organization in existence on or prior to the date regulations are proposed may support more than five supported organizations only if the organization distributes at least 85 percent of its total required payout amount to, or for the use of, publicly supported organizations to which the supporting organization is responsive pursuant to Treas. Reg. § 1.509(a)–4(i)(2)(ii). The anticipated proposed payout rules are intended to ensure that a non-functionally integrated Type III supporting organization has a tight nexus with its supported organization(s).

The Treasury Department and the IRS recognize that requiring an existing Type III supporting organization that supports more than five supported organizations to provide 85 percent of its total required payout to those supported organizations to which it is responsive may affect existing donee relationships. The Treasury Department and the IRS solicit comments on whether transitional rules are needed with respect to this proposed limitation regarding distributions to supported organizations.

The valuation of assets for purposes of the payout requirement is expected to be determined in a manner similar to that under section 4942(e)(2) and Treas. Reg. § 53.4942(a)–2(c)(4). The proposed distribution rules will be similar to the distribution rules under section 4942. It is expected that amounts paid by an organization to accomplish the exempt purposes of its supported organizations will be considered as distributed to or for the use of its supported organization(s).

Responsiveness Test

Except as explained below with respect to charitable trusts, the Treasury Department and the IRS do not expect to modify the responsiveness test. Thus, all Type III supporting organizations will be expected to meet the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). Accordingly, a Type III supporting organization will be expected to demonstrate the necessary relationship between its officers, directors or trustees and those of its supported organization(s), and further show that this relationship results in the officers, directors or trustees of its supported organization(s) having a significant voice in the operations of the supporting organization.

Responsiveness Test for Charitable Trusts

Consistent with section 1241(c) of the PPA, discussed in the Background section above, the proposed regulations will provide that charitable trusts must satisfy the responsiveness test under Treas. Reg. § 1.509(a)–4(i)(2)(ii). Thus, for instance, a trust would be expected to show that its trustees have a close, continuous working relationship with the officers, directors, or trustees of the publicly supported organization(s) it supports and that through such relationship the officers, directors or trustees of its publicly supported organization(s) have a significant voice in the operations of the supporting organization. Comments are requested with respect to potential transition relief given that the statute directs that this modified test apply as of August 17, 2007 to trusts already in existence on the date of enactment of the PPA.

Requirement to Provide Supported Organizations with Information Regarding Responsiveness

The proposed regulations will provide rules for the form, content and timing of the information Type III supporting organizations are required to provide their supported organization(s) under section 509(f)(1)(A). The Treasury Department and the IRS solicit comments as to what information the Secretary should require a Type III supporting organization to provide to each of its supported organizations to ensure that such supporting organization is responsive to the needs or demands of its supported organization(s).

Consequences for Failing to Satisfy the Proposed Tests

The proposed regulations will clarify that an organization that would otherwise be classified as a Type III supporting organization, but either does not establish that it is functionally integrated or does not satisfy the payout requirement for non-functionally integrated organizations in a taxable year, will be classified as a private foundation for such taxable year and all subsequent taxable years until it terminates its private foundation status under section 507. The Treasury Department and the IRS solicit comments on how the requirements for a private foundation termination under section 507 should apply in these circumstances.

Transitional Issues

Implementation of the new qualification requirements for Type III supporting organizations enacted in the PPA will raise transitional issues for certain organizations. For instance, an organization that currently qualifies as a Type III supporting organization by meeting the attentiveness prong of the integral part test might be prohibited by its current governing instrument from distributing capital or corpus, thus preventing it from being able to satisfy the new payout requirement for non-functionally integrated Type III supporting organizations without a change to such instrument. The Treasury Department and the IRS invite comments regarding potential transition rules for supporting organizations in existence as of the date of enactment of the PPA that will provide such organizations a reasonable opportunity to amend their governing instruments or make other changes to comply with the law as amended by the PPA.

Proposed Effective Date

Except as otherwise noted, the Treasury Department and the IRS anticipate that these new proposed rules for Type III supporting organizations would apply to taxable years with respect to each organization beginning after the date these rules are published in the Federal Register as final or temporary regulations.

Request for Comments

Before the notice of proposed rulemaking is issued, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying.

Drafting Information

The principal authors of this advance notice of proposed rulemaking are Philip T. Hackney and Michael B. Blumenfeld, Office of the Chief Counsel (Tax-exempt and Government Entities), however, other personnel from the IRS and the Treasury Department participated in its development.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 1, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 2, 2007, 72 F.R. 42335)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 21.—Expenses for Household and Dependent Care Services Necessary for Gainful Employment

26 CFR 1.21–1: Expenses for household and dependent care services necessary for gainful employment.

T.D. 9354

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Expenses for Household and Dependent Care Services Necessary for Gainful Employment

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the credit for expenses for household and dependent care services necessary for gainful employment. The regulations reflect statutory amendments under the Deficit Reduction Act of 1984, the Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1987, the Family Support Act of 1988, the Small Business Job Protection Act of 1996, the Economic Growth and Tax Relief Reconciliation Act of 2001, the Job Creation and Worker Assistance Act of 2002, the Working Families Tax Relief Act of 2004, and the Gulf Opportunity Zone Act of 2005. The regulations affect taxpayers who claim the credit for expenses for household and dependent care services, and dependent care providers.

DATES: *Effective Date:* These regulations are effective August 14, 2007.

Applicability Date: For date of applicability, see §1.21–1(l).

FOR FURTHER INFORMATION CONTACT: Amy Pfalzgraf, (202) 622–4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final amendments to the Income Tax Regulations, 26 CFR part 1, relating to the credit for expenses for household and dependent care services necessary for gainful employment (the credit) under section 21 of the Internal Revenue Code (Code).

On May 24, 2006, a notice of proposed rulemaking (REG–139059–02, 2006–1 C.B. 1052) regarding the credit was published in the **Federal Register** (71 FR 29847). Written and electronic comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The comments and revisions are discussed in the preamble.

Explanation of Provisions and Summary of Comments

1. *Time of Payment and Performance of Services*

Section 21(b)(2) provides, in part, that employment-related expenses are amounts paid to enable a taxpayer to be gainfully employed for a period for which there are one or more qualifying individuals with respect to a taxpayer. The proposed regulations provide that a taxpayer may take expenses into account under section 21 only in the later of the taxable year the services are performed or the taxable year the expenses are paid. The proposed regulations also provide that the status of an individual as a qualifying individual is determined on a daily basis, that a taxpayer may take into account only expenses that qualify before a disqualifying event, such as a child turning 13, and that the requirements of section 21 and the regulations are applied at the time the services are performed, regardless of when the expenses are paid.

A verbal comment inquired whether, to be creditable, expenses must be paid and services must be performed before a disqualifying event.

The determination of whether expenses qualify as employment-related expenses, including whether an individual is a qualifying individual, can be made only at the time services are performed. Only expenses for the care of a qualifying individual that are for the purpose of enabling the taxpayer to be gainfully employed qualify for the credit. Therefore, services must be performed prior to a disqualifying event and at a time when the purpose is to enable the taxpayer to be gainfully employed. For purposes of determining whether expenses are employment-related expenses, the time of payment is irrelevant, although payment must be made before the credit is claimed. The final regulations provide examples to illustrate these rules.

2. *Care of Qualifying Individual and Household Services*

Under section 21(b)(2)(A), expenses are employment-related only if the expenses are primarily for household services or for the care of a qualifying individual. The proposed regulations provide that the primary purpose of expenses for the care of a qualifying individual must be to assure that individual's well-being and protection.

a. *Costs for education*

The proposed regulations provide that expenses for a child in nursery school, preschool, or similar programs for children below the kindergarten level are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for care and therefore, are not employment-related expenses. However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be for care.

Commentators noted that some public school systems offer only half-day kindergarten, and that some parents send their children to private kindergarten because it offers a full-day program. Under the proposed regulations, a parent whose child attends a half-day kindergarten may claim the credit for the cost of an afternoon

after-school program. However, a parent whose child attends a full-day private kindergarten may not claim the credit for the cost of services performed in the afternoon, because the services are part of the kindergarten program and not after-school care. Commentators suggested that taxpayers who send their children to full-day private kindergarten should be allowed some apportionment of expenses for the afternoon portion of the kindergarten.

The final regulations do not adopt this comment. Kindergarten programs are primarily educational. See, for example, section 62(d)(1) (definitions of eligible educator and school) and section 530(b)(3)(B) (definition of school). Although nursery school and other programs below the level of kindergarten also may include significant educational elements, for administrative convenience the proposed regulations treat these programs as for care. The final regulations retain these rules for greater ease of administration.

A commentator suggested that amounts paid for sending a child to a private school by a taxpayer living overseas should be an employment-related expense if public education is not available. The final regulations do not adopt this comment. Employment-related expenses must be for the care of a qualifying individual and may not be for other services such as education.

b. *Specialty day camps*

The proposed regulations provide that the full amount paid for a day camp or similar program may be for the care of a qualifying individual although the camp specializes in a particular activity, such as soccer or computers. For administrative convenience, no allocation is required in this situation between the cost of care and amounts paid for learning a specialized skill.

A verbal comment requested that the regulations clarify that summer school is not day camp and that the cost of summer school is not creditable. Another commentator commended the proposed regulations for allowing the credit for the cost of "education day camps" that focus on reading, math, writing, and study skills.

The final regulations retain the rule that no allocation is required for the cost of a specialty day camp, but clarify that expenses for summer school and tutoring programs are not creditable. Summer school and tutoring programs are indistinguishable from school and are education, not care. The final regulations provide examples to illustrate these rules.

Section 21(b)(2)(C) provides, in part, that the cost of services performed by a dependent care center are employment-related expenses only if the dependent care center complies with the applicable laws of the state and local government. A commentator requested that the regulations clarify whether a day camp is a dependent care center and must comply with this requirement. The final regulations clarify that the requirements of section 21(b)(2)(C) apply to day camps that meet the definition of dependent care center in section 21(b)(2)(D).

c. *Sick child centers*

A commentator asserted that sick child centers that provide care for children with illnesses who cannot be cared for by the primary care provider primarily provide dependent care and that any medical care provided is incidental. The commentator suggested that these costs may be employment-related expenses.

The final regulations do not adopt this comment. A taxpayer may take an amount into account as either an employment-related expense under section 21 or an expense for medical care under section 213 (but not both). See section 213(e). Whether the care provided at a sick child center assures a child's well-being and protection or constitutes medical care is a factual matter that must be determined on a case-by-case basis.

d. *Boarding school*

The proposed regulations provide that an allocation must be made between expenses for the care of a qualifying individual and expenses for other goods or services, unless the other goods or services are incidental to and inseparably a part of the care. Specifically, amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. The proposed regulations provide an example requiring a taxpayer to allocate the costs of a boarding school between care and education, meals, and housing.

A commentator stated that the example does not provide clear guidance for determining which expenses are for care and whether lodging and meals could be considered incidental and therefore, part of care. The commentator suggested that meals and lodging at a boarding school are incidental to and inseparably a part of the care provided.

The final regulations do not adopt this comment. The example and the regulations clearly distinguish care from food, lodging, and education provided by a boarding school, which are not for the care of a qualifying individual, or incidental to or inseparably a part of the care provided.

e. *Expenses for room and board of a caregiver*

The proposed regulations provide that the additional cost of providing room and board for a caregiver over usual household expenses may be an employment-related expense. This rule is based on Rev. Rul. 76–288, 1976–2 C.B. 83, which holds that under the predecessor to section 21, a taxpayer furnishing meals and lodging to a housekeeper who provides care may deduct the allocable expenses attributable to the housekeeper that are in addition to normal household expenses. The ruling provides an example allowing a taxpayer to take into account the additional cost of rent for an apartment with an additional bedroom to accommodate the housekeeper and additional utilities attributable to the housekeeper.

The proposed regulations provide that the general substantiation rules of section 6001 and the implementing regulations apply to taxpayers claiming the credit. A commentator stated that the regulations should clarify whether an increase in utilities (such as electric, water, and gas) may be employment-related expenses and what constitutes acceptable proof of costs.

The final regulations adopt the first of these comments and include an example similar to the example in Rev. Rul. 76–288. However, the final regulations do not provide special substantiation rules for these costs. These rules encompass substantiation of allocations by taxpayers claiming the credit with respect to the additional cost of providing room and board for a caregiver.

f. *Cost of overnight camp*

A commentator suggested that the credit should be allowed for a portion of the cost of overnight camp allocable to time when parents work. The final regulations do not adopt this comment. Under section 21(b)(2), the cost of overnight camp is not an employment-related expense.

3. *Expenses Enabling a Taxpayer to Be Gainfully Employed*

Under section 21(b)(2)(A), expenses are employment-related only if the taxpayer's purpose in obtaining the services is to enable the taxpayer to be gainfully employed. The expenses must be for periods during which the taxpayer is gainfully employed or is in active search of gainful employment.

a. *Short, temporary absence exception*

The proposed regulations provide that a taxpayer must allocate the cost of care on a daily basis if expenses are paid for a period during only part of which the taxpayer is employed or in active search of gainful employment. The proposed regulations provide an exception to the allocation requirement for a short, temporary absence from work for a taxpayer paying for dependent care on a weekly, monthly, or annual basis. Whether an absence is a short, temporary absence is determined based on all the facts and circumstances. The proposed regulations requested comments on an appropriate period to constitute a temporary absence safe harbor.

A commentator suggested that the exception for short, temporary absences should not be limited to taxpayers who pay employment-related expenses on a weekly, monthly, or annual basis. The commentator stated that regardless of payment schedule, taxpayers who take their children out of care due to a short illness or vacation typically must pay for that care when absent or risk losing it.

The final regulations adopt this comment and delete the provision that the temporary absence exception applies only to taxpayers who must pay for care on a weekly, monthly, or annual basis. The final regulations clarify, however, that only those costs that the taxpayer is required to pay during the absence qualify for the exception. The final regulations provide examples to illustrate these rules.

A commentator suggested that a length of absence that is less than a taxpayer's pay period should be deemed to be a short, temporary absence for that taxpayer, up to a maximum of 2 weeks. For example, the maximum short, temporary absence period of a taxpayer with a 1-week pay period would be 4 days. The final regulations do not adopt this comment, which would result in disparate treatment of taxpayers based on length of pay period.

A commentator suggested that the final regulations should adopt 12 weeks as a temporary absence safe harbor. The commentator based this suggestion on the Family Medical Leave Act (FMLA), which guarantees workers a maximum of 12 weeks of unpaid leave for the birth or adoption of a child and other purposes. The final regulations do not adopt this comment. Different policies underlie the FMLA and the dependent care credit. An absence of 12 weeks is not a short, temporary absence for purposes of claiming the credit.

The final regulations include a safe harbor that treats an absence of no more than 2 consecutive calendar weeks as a short, temporary absence, and modify the examples to illustrate this rule.

b. *Other costs*

A commentator suggested that the final regulations should clarify that expenses may be paid to enable a taxpayer to be gainfully employed and may be employment-related expenses if one parent works during the day and the other parent works at night, and the expenses are for care while one parent is working and the other is sleeping. Another commentator suggested that the cost of overnight care (not overnight camp) should be an employment-related expense for a taxpayer who works at night. The final regulations include examples illustrating that expenses may be employment-related expenses in these situations.

Commentators suggested that the cost of care should be treated as an employment-related expense for any period that a taxpayer is on short- or long-term disability, leave under the FMLA, paid medical leave, or paid maternity leave. The final regulations do not adopt these comments as these rules would be inconsistent with the statutory requirement that expenses are employment-related expenses only if paid to enable the taxpayer to be gainfully employed.

4. *Limitations on Amount Creditable*

a. *Dollar limit*

Commentators suggested that the dollar limit on employment-related expenses should be increased from $3,000 for one qualifying child and $6,000 for two or more qualifying children, to $5,000 for each qualifying child. The final regulations do not adopt these comments as they are inconsistent with the statutory limitations.

b. *Student at an educational organization*

For purposes of the deemed earned income of a spouse who is a full-time student, section 21(e)(7) and (8) defines *student* as an individual who, during each of 5 calendar months during the taxable year, is a full-time student at an educational organization described in section 170(b)(1)(A)(ii). Section 170(b)(1)(A)(ii) provides that an educational organization normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

A commentator suggested that a full-time student in an on-line degree program is a full-time student at an educational organization. The final regulations do not adopt this comment. A degree program offered by an organization that provides instruction exclusively over the internet (as opposed to an organization that provides courses on-line as well as traditional classroom instruction) does not have students in attendance at the place where its educational activities are regularly carried on and is not an educational organization within the meaning of section 170(b)(1)(A)(ii). Accordingly, an individual enrolled in a program provided by an organization that offers only on-line instruction is not a student for purposes of the deemed earned income rule. However, an individual who takes on-line courses at an organization that has traditional classroom instruction as well as on-line

courses, and that otherwise meets the definition of educational organization under section 170(b)(1)(A)(ii), may be a student for purposes of the deemed earned income rule.

The final regulations delete the cross-reference in the proposed regulations to the definition of student in section 152(f)(2) (for taxable years beginning after December 31, 2004) or section 151(c)(4) (for taxable years beginning before January 1, 2005), and the regulations thereunder, as that term is defined in section 21(e)(7) and (8) and these regulations.

5. *Substantiation*

The proposed regulations provide that taxpayers claiming a credit for employment-related expenses must maintain adequate records or other sufficient evidence to substantiate the expenses in accordance with section 6001 and the regulations thereunder.

A commentator suggested that dependent care assistance program administrators should be able to rely on the representations of plan participants, without additional documentation, to establish that indirect expenses are required and are subject to forfeiture, the proper expense allocation for part-time employees, and whether expenses are paid on a weekly or monthly basis. The final regulations do not adopt this comment as these situations do not present unusual substantiation issues.

6. *Conforming Changes*

The final regulations incorporate several changes to conform to amendments to the statute. The final regulations reflect that the special dependency rule of section 21(e)(5) applies to children of parents who live apart at all times during the last 6 months of the calendar year as well as to the children of separated or divorced parents. The final regulations reflect the changes made to the definitions of *qualifying individual* and *custodial parent* by the Gulf Opportunity Zone Act of 2005 (Public Law No. 109–135, 119 Stat. 2577). Finally, the final regulations clarify that, for taxable years beginning after December 31, 2004, costs for care outside the taxpayer's household of a qualifying individual who is a dependent or spouse incapable of self-care who regularly spends at least 8 hours each day in the taxpayer's household may continue to qualify for the credit.

7. *Effective Date*

The final regulations apply to taxable years ending after August 14, 2007.

Effect on Other Documents

Rev. Rul. 76–278, 1976–2 C.B. 84, and Rev. Rul. 76–288, 1976–2 C.B. 83, are obsoleted as of August 14, 2007.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Amy Pfalzgraf of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Department of the Treasury participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART I — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.21–1 also issued under 26 U.S.C. 21(f).

Section 1.21–2 also issued under 26 U.S.C. 21(f).

Section 1.21–3 also issued under 26 U.S.C. 21(f).

Section 1.21–4 also issued under 26 U.S.C. 21(f) * * *

§1.21–1 [Redesignated as §1.15–1]

Par. 2. Section 1.21–1 is redesignated §1.15–1.

Par. 3. New §§1.21–1, 1.21–2, 1.21–3, and 1.21–4 are added to read as follows:

§1.21–1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) Section 21 allows a credit to a taxpayer against the tax imposed by chapter 1 for employment-related expenses for household services and care (as defined in paragraph (d) of this section) of a qualifying individual (as defined in paragraph (b) of this section). The purpose of the expenses must be to enable the taxpayer to be gainfully employed (as defined in paragraph (c) of this section). For taxable years beginning after December 31, 2004, a qualifying individual must have the same principal place of abode (as defined in paragraph (g) of this section) as the taxpayer for more than one-half of the taxable year. For taxable years beginning before January 1, 2005, the taxpayer must maintain a household (as defined in paragraph (h) of this section) that includes one or more qualifying individuals.

(2) The amount of the credit is equal to the applicable percentage of the employment-related expenses that may be taken into account by the taxpayer during the taxable year (but subject to the limits prescribed in §1.21–2). *Applicable percentage* means 35 percent reduced by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds $15,000, but not less than 20 percent. For example, if a taxpayer's adjusted gross income is $31,850, the applicable percentage is 26 percent.

(3) Expenses may be taken as a credit under section 21, regardless of the taxpayer's method of accounting, only in the taxable year the services are performed or the taxable year the expenses are paid, whichever is later.

(4) The requirements of section 21 and §§1.21–1 through 1.21–4 are applied at the time the services are performed, regardless of when the expenses are paid.

(5) *Examples.* The provisions of this paragraph (a) are illustrated by the following examples.

Example 1. In December 2007, B pays for the care of her child for January 2008. Under paragraph (a)(3) of this section, B may claim the credit in 2008, the later of the years in which the expenses are paid and the services are performed.

Example 2. The facts are the same as in *Example 1*, except that B's child turns 13 on February 1, 2008, and B pays for the care provided in January 2008 on February 3, 2008. Under paragraph (a)(4) of this section, the determination of whether the expenses are employment-related expenses is made when the services are performed. Assuming other requirements are met, the amount B pays will be an employment-related expense under section 21, because B's child is a qualifying individual when the services are performed, even though the child is not a qualifying individual when B pays the expenses.

(b) *Qualifying individual*—(1) *In general.* For taxable years beginning after December 31, 2004, a qualifying individual is—

(i) The taxpayer's dependent (who is a qualifying child within the meaning of section 152) who has not attained age 13;

(ii) The taxpayer's dependent (as defined in section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B)) who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than one-half of the taxable year.

(2) *Taxable years beginning before January 1, 2005.* For taxable years beginning before January 1, 2005, a qualifying individual is—

(i) The taxpayer's dependent for whom the taxpayer is entitled to a deduction for a personal exemption under section 151(c) and who is under age 13;

(ii) The taxpayer's dependent who is physically or mentally incapable of self-care; or

(iii) The taxpayer's spouse who is physically or mentally incapable of self-care.

(3) *Qualification on a daily basis.* The status of an individual as a qualifying individual is determined on a daily basis. An individual is not a qualifying individual on the day the status terminates.

(4) *Physical or mental incapacity.* An individual is physically or mentally incapable of self-care if, as a result of a physical or mental defect, the individual is incapable of caring for the individual's hygiene or nutritional needs, or requires full-time attention of another person for the individual's own safety or the safety of others. The inability of an individual to engage in any substantial gainful activity or to perform the normal household functions of a homemaker or care for minor children by reason of a physical or mental condition does not of itself establish that the individual is physically or mentally incapable of self-care.

(5) *Special test for divorced or separated parents or parents living apart*—(i) *Scope.* This paragraph (b)(5) applies to a child (as defined in section 152(f)(1) for taxable years beginning after December 31, 2004, and in section 151(c)(3) for taxable years beginning before January 1, 2005) who—

(A) Is under age 13 or is physically or mentally incapable of self-care;

(B) Receives over one-half of his or her support during the calendar year from one or both parents who are divorced or legally separated under a decree of divorce or separate maintenance, are separated under a written separation agreement, or live apart at all times during the last 6 months of the calendar year; and

(C) Is in the custody of one or both parents for more than one-half of the calendar year.

(ii) *Custodial parent allowed the credit.* A child to whom this paragraph (b)(5) applies is the qualifying individual of only one parent in any taxable year and is the qualifying child of the custodial parent even if the noncustodial parent may claim the dependency exemption for that child for that taxable year. See section 21(e)(5). The custodial parent is the parent having custody for the greater portion of the calendar year. See section 152(e)(4)(A).

(6) *Example.* The provisions of this paragraph (b) are illustrated by the following examples.

Example. C pays $420 for the care of her child, a qualifying individual, to be provided from January 2 through January 31, 2008 (21 days of care). On January 20, 2008, C's child turns 13 years old. Under paragraph (b)(3) of this section, C's child is a qualifying individual from January 2 through January 19, 2008 (13 days of care). C may take into account $260, the *pro rata* amount C pays for the care of her child for 13 days, under section 21. See §1.21–2(a)(4).

(c) *Gainful employment*—(1) *In general.* Expenses are employment-related expenses only if they are for the purpose of enabling the taxpayer to be gainfully employed. The expenses must be for the care of a qualifying individual or household services performed during periods in which the taxpayer is gainfully employed or is in active search of gainful employment. Employment may consist of service within or outside the taxpayer's home and includes self-employment. An expense is not employment-related merely because it is paid or incurred while the taxpayer is gainfully employed. The purpose of the expense must be to enable the taxpayer to be gainfully employed. Whether the purpose of an expense is to enable the taxpayer to be gainfully employed depends on the facts and circumstances of the particular case. Work as a volunteer or for a nominal consideration is not gainful employment.

(2) *Determination of period of employment on a daily basis*—(i) *In general.* Expenses paid for a period during only part of which the taxpayer is gainfully employed or in active search of gainful employment must be allocated on a daily basis.

(ii) *Exception for short, temporary absences.* A taxpayer who is gainfully employed is not required to allocate expenses during a short, temporary absence from work, such as for vacation or minor illness, provided that the care-giving arrangement requires the taxpayer to pay for care during the absence. An absence of 2 consecutive calendar weeks is a short, temporary absence. Whether an absence longer than 2 consecutive calendar weeks is a short, temporary absence is determined based on all the facts and circumstances.

(iii) *Part-time employment.* A taxpayer who is employed part-time generally must allocate expenses for dependent care between days worked and days not worked. However, if a taxpayer employed part-time is required to pay for dependent care on a periodic basis (such as weekly or monthly) that includes both days worked and days not worked, the taxpayer is not required to allocate the expenses. A day on which the taxpayer works at least 1 hour is a day of work.

(3) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. D works during the day and her husband, E, works at night and sleeps during the day. D and E pay for care for a qualifying individual during the hours when D is working and E is sleeping. Under paragraph (c)(1) of this section, the amount paid by D and E for care may be for the purpose of allowing D and E to be gainfully employed and may be an employment-related expense under section 21.

Example 2. F works at night and pays for care for a qualifying individual during the hours when F is working. Under paragraph (c)(1) of this section, the amount paid by F for care may be for the purpose of allowing F to be gainfully employed and may be an employment-related expense under section 21.

Example 3. G, the custodial parent of two children who are qualifying individuals, hires a housekeeper for a monthly salary to care for the children while G is gainfully employed. G becomes ill and as a result is absent from work for 4 months. G continues to pay the housekeeper to care for the children while G is absent from work. During this 4-month period, G performs no employment services, but receives payments under her employer's wage continuation plan. Although G may be considered to be gainfully employed during her absence from work, the absence is not a short, temporary absence within the meaning of paragraph (c)(2)(ii) of this section, and her payments for household and dependent care services during the period of illness are not for the purpose of enabling her to be gainfully employed. G's expenses are not employment-related expenses, and she may not take the expenses into account under section 21.

Example 4. To be gainfully employed, H sends his child to a dependent care center that complies with all state and local requirements. The dependent care center requires payment for days when a child is absent from the center. H takes 8 days off from work as vacation days. Because the absence is less than 2 consecutive calendar weeks, under paragraph (c)(2)(ii) of this section, H's absence is a short, temporary absence. H is not required to allocate expenses between days worked and days not worked. The entire fee for the period that includes the 8 vacation days may be an employment-related expense under section 21.

Example 5. J works 3 days per week and her child attends a dependent care center (that complies with all state and local requirements) to enable her to be gainfully employed. The dependent care center allows payment for any 3 days per week for $150 or 5 days per week for $250. J enrolls her child for 5 days per week, and her child attends the care center for 5 days per week. Under paragraph (c)(2)(iii) of this section, J must allocate her expenses for dependent care between days worked and days not worked. Three-fifths of the $250, or $150 per week, may be an employment-related expense under section 21.

Example 6. The facts are the same as in *Example 5*, except that the dependent care center does not offer a 3-day option. The entire $250 weekly fee may be an employment-related expense under section 21.

(d) *Care of qualifying individual and household services*—(1) *In general.* To qualify for the dependent care credit, expenses must be for the care of a qualifying individual. Expenses are for the care of a qualifying individual if the primary function is to assure the individual's well-being and protection. Not all expenses relating to a qualifying individual are for the individual's care. Amounts paid for food, lodging, clothing, or education are not for the care of a qualifying individual. If, however, the care is provided in such a manner that the expenses cover other goods or services that are incidental to and inseparably a part of the care, the full amount is for care.

(2) *Allocation of expenses.* If an expense is partly for household services or for the care of a qualifying individual and partly for other goods or services, a reasonable allocation must be made. Only so much of the expense that is allocable to the household services or care of a qualifying individual is an employment-related expense. An allocation must be made if a housekeeper or other domestic employee performs household duties and cares for the qualifying children of the taxpayer and also performs other services for the taxpayer. No allocation is required, however, if the expense for the other purpose is minimal or insignificant or if an expense is partly attributable to the care of a qualifying individual and partly to household services.

(3) *Household services.* Expenses for household services may be employment-related expenses if the services are performed in connection with the care of a qualifying individual. The household services must be the performance in and about the taxpayer's home of ordinary and usual services necessary to the maintenance of the household and attributable to the care of the qualifying individual. Services of a housekeeper are household services within the meaning of this paragraph (d)(3) if the services are provided, at least in part, to the qualifying individual. Such services as are performed by chauffeurs, bartenders, or gardeners are not household services.

(4) *Manner of providing care.* The manner of providing care need not be the least expensive alternative available to the taxpayer. The cost of a paid caregiver may be an expense for the care of a qualifying individual even if another caregiver is available at no cost.

(5) *School or similar program.* Expenses for a child in nursery school, preschool, or similar programs for children below the level of kindergarten are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for the care of a qualifying individual. However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be for the care of a qualifying individual.

(6) *Overnight camps.* Expenses for overnight camps are not employment-related expenses.

(7) *Day camps.* (i) The cost of a day camp or similar program may be for the care of a qualifying individual and an employment-related expense, without allocation under paragraph (d)(2) of this section, even if the day camp specializes in a particular activity. Summer school and tutoring programs are not for the care of a qualifying individual and the costs are not employment-related expenses.

(ii) A day camp that meets the definition of *dependent care center* in section 21(b)(2)(D) and paragraph (e)(2) of this section must comply with the requirements of section 21(b)(2)(C) and paragraph (e)(2) of this section.

(8) *Transportation.* The cost of transportation by a dependent care provider of a qualifying individual to or from a place where care of that qualifying individual is provided may be for the care of the qualifying individual. The cost of transportation not provided by a dependent care provider is not for the care of the qualifying individual.

(9) *Employment taxes.* Taxes under sections 3111 (relating to the Federal Insurance Contributions Act) and 3301 (relating to the Federal Unemployment Tax Act) and similar state payroll taxes are employment-related expenses if paid in respect of wages that are employment-related expenses.

(10) *Room and board.* The additional cost of providing room and board for a caregiver over usual household expenditures may be an employment-related expense.

(11) *Indirect expenses.* Expenses that relate to, but are not directly for, the care of a qualifying individual, such as application fees, agency fees, and deposits, may be for the care of a qualifying individual and may be employment-related expenses if the taxpayer is required to pay the expenses to obtain the related care. However, forfeited deposits and other payments are not for the care of a qualifying individual if care is not provided.

(12) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. To be gainfully employed, K sends his 3-year old child to a pre-school. The pre-school provides lunch and snacks. Under paragraph (d)(1) of this section, K is not required to allocate expenses between care and the lunch and snacks, because the lunch and snacks are incidental to and inseparably a part of the care. Therefore, K may treat the full amount paid to the pre-school as for the care of his child.

Example 2. L, a member of the armed forces, is ordered to a combat zone. To be able to comply with the orders, L places her 10-year old child in boarding school. The school provides education, meals, and housing to L's child in addition to care. Under paragraph (d)(2) of this section, L must allocate the cost of the boarding school between expenses for care and expenses for education and other services not constituting care. Only the part of the cost of the boarding school that is for the care of L's child is an employment-related expense under section 21.

Example 3. To be gainfully employed, M employs a full-time housekeeper to care for M's two children, aged 9 and 13 years. The housekeeper regularly performs household services of cleaning and cooking and drives M to and from M's place of employment, a trip of 15 minutes each way. Under paragraph (d)(3) of this section, the chauffeur services are not household services. M is not required to allocate a portion of the expense of the housekeeper to the chauffeur services under paragraph (d)(2) of this section, however, because the chauffeur services are minimal and insignificant. Further, no allocation under paragraph (d)(2) of this section is required to determine the portion of the expenses attributable to the care of the 13-year old child (not a qualifying individual) because the household expenses are in part attributable to the care of the 9-year old child. Accordingly, the entire expense of employing the housekeeper is an employment-related expense. The amount that M may take into account as an employment-related expense under section 21, however, is limited to the amount allowable for one qualifying individual.

Example 4. To be gainfully employed, N sends her 9-year old child to a summer day camp that offers computer activities and recreational activities such as swimming and arts and crafts. Under paragraph (d)(7)(i) of this section, the full cost of the summer day camp may be for care.

Example 5. To be gainfully employed, O sends her 9-year old child to a math tutoring program for two hours per day during the summer. Under paragraph (d)(7)(i) of this section, the cost of the tutoring program is not for care.

Example 6. To be gainfully employed, P hires a full-time housekeeper to care for her 8-year old child. In order to accommodate the housekeeper, P moves from a 2-bedroom apartment to a 3-bedroom apartment that otherwise is comparable to the 2-bedroom apartment. Under paragraph (d)(10) of this section, the additional cost to rent the 3-bedroom apartment over the cost of the 2-bedroom apartment and any additional utilities attributable to the housekeeper's residence in the household may be employment-related expenses under section 21.

Example 7. Q pays a fee to an agency to obtain the services of an au pair to care for Q's children, qualifying individuals, to enable Q to be gainfully employed. An au pair from the agency subsequently provides care for Q's children. Under paragraph (d)(11) of this section, the fee may be an employment-related expense.

Example 8. R places a deposit with a pre-school to reserve a place for her child. R sends the child to a different pre-school and forfeits the deposit. Under paragraph (d)(11) of this section, the forfeited deposit is not an employment-related expense.

(e) *Services outside the taxpayer's household*—(1) *In general.* The credit is allowable for expenses for services performed outside the taxpayer's household only if the care is for one or more qualifying individuals who are described in this section at—

(i) Paragraph (b)(1)(i) or (b)(2)(i); or

(ii) Paragraph (b)(1)(ii), (b)(2)(ii), (b)(1)(iii), or (b)(2)(iii) and regularly spend at least 8 hours each day in the taxpayer's household.

(2) *Dependent care centers*—(i) *In general.* The credit is allowable for services performed by a dependent care center only if—

(A) The center complies with all applicable laws and regulations, if any, of a state or local government, such as state or local licensing requirements and building and fire code regulations; and

(B) The requirements provided in this paragraph (e) are met.

(ii) *Definition.* The term *dependent care center* means any facility that provides full-time or part-time care for more than six individuals (other than individuals who reside at the facility) on a regular basis during the taxpayer's taxable year, and receives a fee, payment, or grant for providing services for the individuals (regardless of whether the facility is operated for profit). For purposes of the preceding sentence, a facility is presumed to provide full-time or part-time care for six or fewer individuals on a regular basis during the taxpayer's taxable year if the facility has six or fewer individuals (including the taxpayer's qualifying individual) enrolled for full-time or part-time care on the day the qualifying individual is enrolled in the facility (or on the first day of the taxable year the qualifying individual attends the facility if the qualifying individual was enrolled in the facility in the preceding taxable year) unless the Internal Revenue Service demonstrates that the facility provides full-time or part-time care for more than six individuals on a regular basis during the taxpayer's taxable year.

(f) *Reimbursed expenses.* Employment-related expenses for which the taxpayer is reimbursed (for example, under a dependent care assistance program) may not be taken into account for purposes of the credit.

(g) *Principal place of abode.* For purposes of this section, the term *principal place of abode* has the same meaning as in section 152.

(h) *Maintenance of a household*—(1) *In general.* For taxable years beginning before January 1, 2005, the credit is available only to a taxpayer who maintains a household that includes one or more qualifying individuals. A taxpayer maintains a household for the taxable year (or lesser period) only if the taxpayer (and spouse, if applicable) occupies the household and furnishes over one-half of the cost for the taxable year (or lesser period) of maintaining the household. The household must be the principal place of abode for the taxable year of the taxpayer and the qualifying individual or individuals.

(2) *Cost of maintaining a household.* (i) Except as provided in paragraph (h)(2)(ii) of this section, for purposes of this section, the term *cost of maintaining a household* has the same meaning as in §1.2–2(d) without regard to the last sentence thereof.

(ii) The cost of maintaining a household does not include the value of services performed in the household by the taxpayer or by a qualifying individual described in paragraph (b) of this section or any expense paid or reimbursed by another person.

(3) *Monthly proration of annual costs.* In determining the cost of maintaining a household for a period of less than a taxable year, the cost for the entire taxable year must be prorated on the basis of the number of calendar months within that period. A period of less than a calendar month is treated as a full calendar month.

(4) *Two or more families.* If two or more families occupy living quarters in common, each of the families is treated as maintaining a separate household. A taxpayer is maintaining a household if the taxpayer provides more than one-half of the cost of maintaining the separate household. For example, if two unrelated taxpayers with their respective children occupy living quarters in common and each

taxpayer pays more than one-half of the household costs for each respective family, each taxpayer is treated as maintaining a household.

(i) Reserved.

(j) *Expenses qualifying as medical expenses*—(1) *In general.* A taxpayer may not take an amount into account as both an employment-related expense under section 21 and an expense for medical care under section 213.

(2) *Examples.* The provisions of this paragraph (j) are illustrated by the following examples:

Example 1. S has $6,500 of employment-related expenses for the care of his child who is physically incapable of self-care. The expenses are for services performed in S's household that also qualify as expenses for medical care under section 213. Of the total expenses, S may take into account $3,000 under section 21. S may deduct the balance of the expenses, or $3,500, as expenses for medical care under section 213 to the extent the expenses exceed 7.5 percent of S's adjusted gross income.

Example 2. The facts are the same as in *Example 1*, however, S first takes into account the $6,500 of expenses under section 213. S deducts $500 as an expense for medical care, which is the amount by which the expenses exceed 7.5 percent of his adjusted gross income. S may not take into account the $6,000 balance as employment-related expenses under section 21, because he has taken the full amount of the expenses into account in computing the amount deductible under section 213.

(k) *Substantiation.* A taxpayer claiming a credit for employment-related expenses must maintain adequate records or other sufficient evidence to substantiate the expenses in accordance with section 6001 and the regulations thereunder.

(l) *Effective/applicability date.* This section and §§1.21–2 through 1.21–4 apply to taxable years ending after August 14, 2007.

§1.21–2 Limitations on amount creditable.

(a) *Annual dollar limitation.* (1) The amount of employment-related expenses that may be taken into account under §1.21–1(a) for any taxable year cannot exceed—

(i) $2,400 ($3,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(ii) $4,800 ($6,000 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(2) The amount determined under paragraph (a)(1) of this section is reduced by the aggregate amount excludable from gross income under section 129 for the taxable year.

(3) A taxpayer may take into account the total amount of employment-related expenses that do not exceed the annual dollar limitation although the amount of employment-related expenses attributable to one qualifying individual is disproportionate to the total employment-related expenses. For example, a taxpayer with expenses in 2007 of $4,000 for one qualifying individual and $1,500 for a second qualifying individual may take into account the full $5,500.

(4) A taxpayer is not required to prorate the annual dollar limitation if a qualifying individual ceases to qualify (for example, by turning age 13) during the taxable year. However, the taxpayer may take into account only amounts that qualify as employment-related expenses before the disqualifying event. See also §1.21–1(b)(6).

(b) *Earned income limitation*—(1) *In general.* The amount of employment-related expenses that may be taken into account under section 21 for any taxable year cannot exceed—

(i) For a taxpayer who is not married at the close of the taxable year, the taxpayer's earned income for the taxable year; or

(ii) For a taxpayer who is married at the close of the taxable year, the lesser of the taxpayer's earned income or the earned income of the taxpayer's spouse for the taxable year.

(2) *Determination of spouse.* For purposes of this paragraph (b), a taxpayer must take into account only the earned income of a spouse to whom the taxpayer is married at the close of the taxable year. The spouse's earned income for the entire taxable year is taken into account, however, even though the taxpayer and the spouse were married for only part of the taxable year. The taxpayer is not required to take into account the earned income of a spouse who died or was divorced or separated from the taxpayer during the taxable year. See §1.21–3(b) for rules providing that certain married taxpayers legally separated or living apart are treated as not married.

(3) *Definition of earned income.* For purposes of this section, the term *earned income* has the same meaning as in section 32(c)(2) and the regulations thereunder.

(4) *Attribution of earned income to student or incapacitated spouse.* (i) For purposes of this section, a spouse is deemed, for each month during which the spouse is a full-time student or is a qualifying individual described in §1.21–1(b)(1)(iii) or (b)(2)(iii), to be gainfully employed and to have earned income of not less than—

(A) $200 ($250 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year; or

(B) $400 ($500 for taxable years beginning after December 31, 2002, and before January 1, 2011) if there are two or more qualifying individuals with respect to the taxpayer at any time during the taxable year.

(ii) For purposes of this paragraph (b)(4), a full-time student is an individual who, during each of 5 calendar months of the taxpayer's taxable year, is enrolled as a student for the number of course hours considered to be a full-time course of study at an educational organization as defined in section 170(b)(1)(A)(ii). The enrollment for 5 calendar months need not be consecutive.

(iii) Earned income may be attributed under this paragraph (b)(4), in the case of any husband and wife, to only one spouse in any month.

(c) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. In 2007, T, who is married to U, pays employment-related expenses of $5,000 for the care of one qualifying individual. T's earned income for the taxable year is $40,000 and her husband's earned income is $2,000. T did not exclude any dependent care assistance under section 129. Under paragraph (b)(1) of this section, T may take into account under section 21 only the amount of employment-related expenses that does not exceed the lesser of her earned income or the earned income of U, or $2,000.

Example 2. The facts are the same as in *Example 1* except that U is a full-time student at an educational organization within the meaning of section 170(b)(1)(A)(ii) for 9 months of the taxable year and has no earned income. Under paragraph (b)(4) of this section, U is deemed to have earned income of $2,250. T may take into account $2,250 of employment-related expenses under section 21.

Example 3. For all of 2007, V is a full-time student and W, V's husband, is an individual who is incapable of self-care (as defined in §1.21–1(b)(1)(iii)).

V and W have no earned income and pay expenses of $5,000 for W's care. Under paragraph (b)(4) of this section, either V or W may be deemed to have $3,000 of earned income. However, earned income may be attributed to only one spouse under paragraph (b)(4)(iii) of this section. Under the limitation in paragraph (b)(1)(ii) of this section, the lesser of V's and W's earned income is zero. V and W may not take the expenses into account under section 21.

(d) *Cross-reference.* For an additional limitation on the credit under section 21, see section 26.

§1.21–3 Special rules applicable to married taxpayers.

(a) *Joint return requirement.* No credit is allowed under section 21 for taxpayers who are married (within the meaning of section 7703 and the regulations thereunder) at the close of the taxable year unless the taxpayer and spouse file a joint return for the taxable year. See section 6013 and the regulations thereunder relating to joint returns of income tax by husband and wife.

(b) *Taxpayers treated as not married.* The requirements of paragraph (a) of this section do not apply to a taxpayer who is legally separated under a decree of divorce or separate maintenance or who is treated as not married under section 7703(b) and the regulations thereunder (relating to certain married taxpayers living apart). A taxpayer who is treated as not married under this paragraph (b) is not required to take into account the earned income of the taxpayer's spouse for purposes of applying the earned income limitation on the amount of employment-related expenses under §1.21–2(b).

(c) *Death of married taxpayer.* If a married taxpayer dies during the taxable year and the survivor may make a joint return with respect to the deceased spouse under section 6013(a)(3), the credit is allowed for the year only if a joint return is made. If, however, the surviving spouse remarries before the end of the taxable year in which the deceased spouse dies, a credit may be allowed on the decedent spouse's separate return.

§1.21–4 Payments to certain related individuals.

(a) *In general.* A credit is not allowed under section 21 for any amount paid by the taxpayer to an individual—

(1) For whom a deduction under section 151(c) (relating to deductions for personal exemptions for dependents) is allowable either to the taxpayer or the taxpayer's spouse for the taxable year;

(2) Who is a child of the taxpayer (within the meaning of section 152(f)(1) for taxable years beginning after December 31, 2004, and section 151(c)(3) for taxable years beginning before January 1, 2005) and is under age 19 at the close of the taxable year;

(3) Who is the spouse of the taxpayer at any time during the taxable year; or

(4) Who is the parent of the taxpayer's child who is a qualifying individual described in §1.21–1(b)(1)(i) or (b)(2)(i).

(b) *Payments to partnerships or other entities.* In general, paragraph (a) of this section does not apply to services performed by partnerships or other entities. If, however, the partnership or other entity is established or maintained primarily to avoid the application of paragraph (a) of this section to permit the taxpayer to claim the credit, for purposes of section 21, the payments of employment-related expenses are treated as made directly to each partner or owner in proportion to that partner's or owner's ownership interest. Whether a partnership or other entity is established or maintained to avoid the application of paragraph (a) of this section is determined based on the facts and circumstances, including whether the partnership or other entity is established for the primary purpose of caring for the taxpayer's qualifying individual or providing household services to the taxpayer.

(c) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. During 2007, X pays $5,000 to her mother for the care of X's 5-year old child who is a qualifying individual. The expenses otherwise qualify as employment-related expenses. X's mother is not her dependent. X may take into account under section 21 the amounts paid to her mother for the care of X's child.

Example 2. Y is divorced and has custody of his 5-year old child, who is a qualifying individual. Y pays $6,000 during 2007 to Z, who is his ex-wife and the child's mother, for the care of the child. The expenses otherwise qualify as employment-related expenses. Under paragraph (a)(4) of this section, Y may not take into account under section 21 the amounts paid to Z because Z is the child's mother.

Example 3. The facts are the same as in *Example 2*, except that Z is not the mother of Y's child. Y may take into account under section 21 the amounts paid to Z.

§§1.44A–1 through 1.44A–4 [Removed]

Par. 4. Sections 1.44A–1, 1.44A–2, 1.44A–3, and 1.44A–4 are removed.

§1.214–1 [Removed]

Par. 5. Section 1.214–1 is removed.

§§1.214A–1 through 1.214A–5 [Removed]

Par. 6. Sections 1.214A–1, 1.214A–2, 1.214A–3, 1.214A–4, and 1.214A–5 are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is amended to remove entries 1.44A–1 and 1.44A–3.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 13, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 14, 2007, 72 F.R. 45338)

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through December 2007. This ruling provides the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through December 2007.

Rev. Rul. 2007–62

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided

guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of bond factor amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period January through December 2007.

Table 1
Rev. Rul. 2007–62
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Jan '07	17.39	32.44	45.52	56.97	66.95	69.23	71.86	74.74	78.09	81.82	85.82
Feb '07	17.39	32.44	45.52	56.97	66.95	69.08	71.70	74.56	77.89	81.60	85.57
Mar '07	17.39	32.44	45.52	56.97	66.95	68.92	71.53	74.39	77.71	81.40	85.33
Apr '07	17.39	32.44	45.52	56.97	66.95	68.77	71.37	74.22	77.52	81.19	85.11
May '07	17.39	32.44	45.52	56.97	66.95	68.62	71.22	74.05	77.35	81.00	84.89
Jun '07	17.39	32.44	45.52	56.97	66.95	68.47	71.06	73.89	77.17	80.81	84.68
Jul '07	17.39	32.44	45.52	56.97	66.95	68.32	70.91	73.74	77.01	80.63	84.47
Aug '07	17.39	32.44	45.52	56.97	66.95	68.18	70.76	73.58	76.84	80.45	84.28
Sep '07	17.39	32.44	45.52	56.97	66.95	68.04	70.62	73.43	76.68	80.27	84.09
Oct '07	17.39	32.44	45.52	56.97	66.95	67.90	70.48	73.28	76.53	80.11	83.90
Nov '07	17.39	32.44	45.52	56.97	66.95	67.77	70.34	73.14	76.37	79.94	83.73
Dec '07	17.39	32.44	45.52	56.97	66.95	67.63	70.20	73.00	76.22	79.78	83.56

Table 1 (cont'd)
Rev. Rul. 2007–62
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2004	2005	2006	2007							
Jan '07	89.79	93.41	96.70	97.21							
Feb '07	89.50	93.07	96.27	97.21							
Mar '07	89.22	92.75	95.89	97.21							
Apr '07	88.96	92.46	95.57	97.21							
May '07	88.72	92.18	95.28	97.21							
Jun '07	88.48	91.93	95.02	97.21							
Jul '07	88.25	91.69	94.79	97.21							
Aug '07	88.04	91.46	94.58	97.21							
Sep '07	87.83	91.25	94.39	97.21							

Table 1 (cont'd)
Rev. Rul. 2007–62
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year										
Month of Disposition	2004	2005	2006	2007							
Oct '07	87.64	91.05	94.22	97.21							
Nov '07	87.45	90.87	94.07	97.21							
Dec '07	87.27	90.69	93.92	97.21							

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3, 1998–1 C.B. 248; Rev. Rul. 2001–2, 2001–1 C.B. 255; Rev. Rul. 2001–53, 2001–2 C.B. 488; Rev. Rul. 2002–72, 2002–2 C.B. 759; Rev. Rul. 2003–117, 2003–2 C.B. 1051; Rev. Rul. 2004–100, 2004–2 C.B. 718; Rev. Rul. 2005–67, 2005–2 C.B. 771; and Rev. Rul. 2006–51, 2006–2 C.B. 632.

DRAFTING INFORMATION

The principal author of this revenue ruling is David McDonnell of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. McDonnell at (202) 622–3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

26 CFR 1.338–6: Allocation of ADSP and AGUB among target assets.

T.D. 9358

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Treatment of Certain Nuclear Decommissioning Funds for Purposes of Allocating Purchase Price in Certain Deemed and Actual Asset Acquisitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the allocation of purchase price in certain deemed and actual asset acquisitions under sections 338 and 1060. These regulations affect sellers and purchasers of nuclear power plants or of the stock of corporations that own nuclear power plants.

DATES: *Effective Date:* These regulations are effective September 11, 2007.

Applicability Date: For dates of applicability, see §§1.338–6(c)(5)(vi) and 1.1060–1(e)(1)(ii)(C)(*4*).

FOR FURTHER INFORMATION CONTACT: Richard Starke at (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 16, 2004, the IRS and Treasury Department issued a notice of proposed rulemaking (REG–169135–03, 2004–2 C.B. 697) and temporary regulations (T.D. 9158, 2004–2 C.B. 665) in the **Federal Register** (69 FR 55740), modifying regulations under sections 338 and 1060 of the Internal Revenue Code (Code). The text of the temporary regulations was identical to the text of the proposed regulations.

Sections 338 and 1060 and the regulations thereunder provide a methodology by which the purchase or sales price in certain actual and deemed asset acquisitions is computed and allocated among the assets acquired or treated as acquired. The regime employs a residual method of allocation that divides assets into seven classes and allocates the consideration to each of the first six classes in turn, up to the fair market value of the assets in the class. The residual amount is allocated to assets in the last class.

The purchase price generally includes liabilities of the seller that are assumed by the purchaser. Those liabilities, however, must be treated as having been incurred by the purchaser. In order to be treated as having been incurred by the purchaser, in addition to other requirements, economic performance must have occurred with respect to the liability.

In connection with the sale of a nuclear power plant, the assets sold by the seller and purchased by the purchaser may in-

clude the plant, equipment, operating assets, and one or more funds holding assets that have been set aside for the purpose of satisfying the owner's responsibility to decommission the nuclear power plant after the conclusion of its useful life (the decommissioning liability), and the purchaser may have agreed to satisfy the decommissioning liability. One or more of such funds may not be a fund described in section 468A. Such other funds are referred to as nonqualified funds. Contributions to nonqualified funds do not give rise to a deduction in the year of contribution. In addition, the assets of a nonqualified fund continue to be treated as assets of the contributor.

The preamble to the proposed and temporary regulations concluded that the decommissioning liability will not satisfy the economic performance test until decommissioning occurs, and therefore that, as of the purchase date, it is not included in the purchase price that the purchaser allocates to the acquired assets. As a result, as of the purchase date, the purchase price to be allocated by the purchaser among the acquired assets may be significantly less than the fair market value of those assets. This situation will generally persist until economic performance with respect to the decommissioning liability is satisfied through decommissioning.

Generally under the residual method, the purchase price is allocated to the nonqualified fund's assets, which are typically Class I and Class II assets, before it is allocated to the plant, equipment, and other operating assets, which are typically Class V assets. Because the purchase price does not reflect the decommissioning liability and is first allocated to the assets of the nonqualified fund, the purchase price allocated to the plant, equipment, and other operating assets may be less than their fair market value. To the extent the purchase price allocated to the plant, equipment, and other operating assets is less than their fair market value, the purchaser will not recover a tax benefit (that is, a depreciation deduction) for the decommissioning liability until economic performance occurs on decommissioning.

To mitigate the tax effect of these decommissioning liabilities' not satisfying the statutory requirements for economic performance as to the purchaser, the temporary regulations added §1.338–6T. That regulation provides that, for purposes of allocating purchase or sales price among the acquisition date assets of a target, a taxpayer may irrevocably elect to treat a nonqualified fund as if such fund were an entity classified as a corporation the stock of which were among the acquisition date assets of the target and a Class V asset. In these cases, for allocation purposes, the hypothetical subsidiary corporation is treated as bearing the responsibility for decommissioning to the extent assets of the fund are expected to be used for that purpose. A section 338(h)(10) election is treated as made for the hypothetical subsidiary corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

The election converts the assets of the nonqualified fund from primarily Class I and Class II assets into stock of a hypothetical subsidiary corporation which is a Class V asset and allows the present cost of the decommissioning liability funded by the nonqualified fund, which otherwise cannot be taken into account for income tax purposes, to be netted against the fund assets for the sole purpose of valuing the stock of the hypothetical subsidiary corporation. Therefore, if the election is made, it is expected that a larger amount of the initial purchase price would be available to be allocated to the plant and other operating assets than if no such election had been made. However, in such a case, a much smaller amount of the initial purchase price would be available to be allocated to the assets of the nonqualified fund. Accordingly, a disposition of the nonqualified fund assets would likely result in current gain recognition.

Explanation of Provisions and Summary of Comments

A number of comments on the proposed regulations were received, the most significant of which are discussed below. No public hearing was requested nor held.

Economic Performance Test

The preamble to the proposed and temporary regulations discussed application of the economic performance test of section 461 to the assumption of decommissioning liabilities by the purchaser. Various commentators requested that, with respect to the purchaser of a nuclear power plant, the economic performance rules outlined in the proposed and temporary regulations be modified to provide that economic performance with respect to an assumed decommissioning liability be deemed to occur at the time of purchase rather than upon performance of the decommissioning activities. Specifically, commentators pointed out that the election in the proposed and temporary regulations will typically result in the purchaser holding the assets of the nonqualified fund with little or no tax basis, and subsequent investment reallocations undertaken during the course of portfolio management will result in gain recognition and a current tax liability. Further, the commentators noted that nonqualified trust agreements related to nuclear decommissioning obligations often require the trustees to remit to the purchasers, out of trust assets, the monies necessary to pay the purchasers' taxes resulting from the trusts' sales of assets. The commentators expressed concern that this requirement will result in fewer assets in the trust to be used to decommission the nuclear power plant because trustees will be required to either remit taxes from the fund or restrict changes in the fund's investment portfolio.

The IRS and Treasury Department recognize that requiring the purchaser to satisfy the economic performance of a liability assumed in a purchase transaction can result in the deferral of the basis of the acquired assets in the hands of the purchaser. However, this result is not unique to the assumption of decommissioning liabilities and therefore, the economic performance concerns raised by commentators extend beyond the scope of these regulations. The final regulations adopt the rules provided in the proposed and temporary regulations which are consistent with the application of economic performance rules of section 461 to liabilities assumed by a purchaser.

The Deemed Section 338(h)(10) Election

Several of the commentators urge that, if the IRS and Treasury Department decline to change the position on economic performance, then the final regulations should eliminate the particular result of the §1.338–6T(c)(5) election set forth in §1.338–6T(c)(5)(i)(E). That provision deems a section 338(h)(10) election to be made with respect to the hypothetical

subsidiary corporation that results from making the §1.338–6T(c)(5) election. The deemed section 338(h)(10) election operates to eliminate any carryover of the historic basis in the assets in the nonqualified decommissioning fund from the seller to the buyer. The commentators maintain that, as a substitute for the §1.338–6T(c)(5) election, the parties to the transaction could preserve the historic basis in the assets in the nonqualified fund by having the seller incorporate the nonqualified fund in a new subsidiary with the subsidiary assuming the appropriate portion of the decommissioning obligation long before the sale of the nuclear power plant.

However, simply eliminating the deemed section 338(h)(10) election that results from making the §1.338–6T(c)(5) election would not necessarily result in the same tax consequences to the parties as a transaction in which the seller incorporated the nonqualified fund in a new subsidiary prior to the sale of the nuclear power plant. The purchase of a subsidiary as opposed to an assumption of the decommissioning liability generally would result in tax accounting differences not only to the buyer but also the seller. Eliminating the deemed section 338(h)(10) election that results from making the §1.338–6T(c)(5) election would have the effect of essentially accelerating economic performance with respect to an assumed nuclear decommissioning liability in a manner inconsistent with the economic performance rules of other assumed liabilities. Therefore, the final regulations adopt the deemed section 338(h)(10) election rule as provided in §1.338–6T(c)(5)(i)(E).

Another group of commentators urge that the §1.338–6T(c)(5) election be made retroactively available prior to September 15, 2004. The allocation rules applicable under sections 338 and 1060 prior to September 15, 2004, however, were comprehensive, and the manner in which they operated was well known to participants in the nuclear power industry. Section 1.338–6T(c)(5) originally was proposed with a prospective effective date, and, while the members of the nuclear power industry at that time urged that §1.338–6T(c)(5) be made available retroactively, the IRS and Treasury Department declined to do so because transactions negotiated prior to September 15, 2004, would have been based on the rules of §1.338–6 without inclusion of §1.338–6T(c)(5). Although the commentators state that the nuclear power industry is very competitive and that some purchasers who purchased nuclear power plants prior to September 15, 2004, might be at a disadvantage relative to those who purchased on or after September 15, 2004, these final regulations are only applicable prospectively so as not to retroactively alter the tax consequences of prior transactions.

Finally, one commentator notes that §1.338–6T(c)(5)(i)(D) treats the hypothetical subsidiary corporation as bearing responsibility for decommissioning only to the extent that assets of the fund are expected to be used for that purpose (the expected use standard). The commentator argues that proving the expected use of the nonqualified assets might be a contentious issue and prove difficult. The commentator proposes that, for purposes of clarity, the hypothetical subsidiary corporation should be treated as bearing the responsibility for decommissioning in an amount equal to the fair market value of the nonqualified fund assets at the time of the closing of the transaction (causing the stock of the hypothetical subsidiary corporation to be assigned a zero value). The commentator suggests that such an approach would eliminate the uncertainty contained in the expected use standard and ensure that no portion of the purchase price is allocated to the nonqualified assets.

The IRS and Treasury Department believe, however, that the implementation of an approach that does not establish a connection between the fund assets and their expected use may lead to the over funding of nonqualified funds in certain circumstances and inappropriate allocations of basis. Accordingly, the final regulations retain the expected use standard.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and pursuant to 5 U.S.C. 553(d)(3) it has been determined that a delayed effective date is unnecessary because this rule finalizes currently effective temporary rules regarding the treatment of certain nuclear decommissioning funds for purposes of allocating purchase price in certain acquisitions without substantive change. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will affect sellers and purchasers of nuclear power plants or the stock of corporations that own nuclear power plants in qualified stock purchases, which tend to be larger businesses. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Richard Starke, Office of the Associate Chief Counsel (Corporate).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for sections 1.338–6T and 1.1060–1T.

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 1.338–0 is amended by removing the entry in the list of captions for §1.338–6T and by revising the entry in the list of captions for paragraph (c)(5) of §1.338–6 to read as follows:

§1.338–0 Outline of topics.

* * * * *

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) Allocation to certain nuclear decommissioning funds.

* * * * *

Par. 3. Paragraph (c)(5) of §1.338–6 is amended to read as follows:

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) *Allocation to certain nuclear decommissioning funds*—(i) *General rule.* For purposes of allocating ADSP or AGUB among the acquisition date assets of a target (and for no other purpose), a taxpayer may elect to treat a nonqualified nuclear decommissioning fund (as defined in paragraph (c)(5)(ii) of this section) of the target as if—

(A) Such fund were an entity classified as a corporation;

(B) The stock of the corporation were among the acquisition date assets of the target and a Class V asset;

(C) The corporation owned the assets of the fund;

(D) The corporation bore the responsibility for decommissioning one or more nuclear power plants to the extent assets of the fund are expected to be used for that purpose; and

(E) A section 338(h)(10) election were made for the corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

(ii) *Definition of nonqualified nuclear decommissioning fund.* A *nonqualified nuclear decommissioning fund* means a trust, escrow account, Government fund or other type of agreement—

(A) That is established in writing by the owner or licensee of a nuclear generating unit for the exclusive purpose of funding the decommissioning of one or more nuclear power plants;

(B) That is described to the Nuclear Regulatory Commission in a report described in 10 CFR 50.75(b) as providing assurance that funds will be available for decommissioning;

(C) That is not a Nuclear Decommissioning Reserve Fund, as described in section 468A;

(D) That is maintained at all times in the United States; and

(E) The assets of which are to be used only as permitted by 10 CFR 50.82(a)(8).

(iii) *Availability of election.* P may make the election described in this paragraph (c)(5) regardless of whether the selling consolidated group (or the selling affiliate or the S corporation shareholders) also makes the election. In addition, the selling consolidated group (or the selling affiliate or the S corporation shareholders) may make the election regardless of whether P also makes the election. If T is an S corporation, all of the S corporation shareholders, including those that do not sell their stock, must consent to the election for the election to be effective as to any S corporation shareholder.

(iv) *Time and manner of making election.* The election described in this paragraph (c)(5) is made by taking a position on an original or amended tax return for the taxable year of the qualified stock purchase that is consistent with having made the election. Such tax return must be filed no later than the later of 30 days after the date on which the section 338 election is due or the day the original tax return for the taxable year of the qualified stock purchase is due (with extensions).

(v) *Irrevocability of election.* An election made pursuant to this paragraph (c)(5) is irrevocable.

(vi) *Effective/applicability date.* This paragraph (c)(5) applies to qualified stock purchases occurring on or after September 11, 2007. For qualified stock purchases occurring before September 11, 2007 and on or after September 15, 2004, see §1.338–6T as contained in 26 CFR Part 1 in effect on April 1, 2007. For qualified stock purchases occurring before September 15, 2004, see §1.338–6 as contained in 26 CFR Part 1 in effect on April 1, 2004.

§1.338–6T [Removed]

Par. 4. Section 1.338–6T is removed.

Par. 5. Section 1.1060–1 is amended by:

1. Revising in the *Outline of Topics* in paragraph (a)(3), the entry for paragraph (e)(1)(ii)(C).

2. Removing the last sentence of paragraph (c)(3) and adding four new sentences in its place.

3. Revising paragraph (e)(1)(ii)(C).

The revisions read as follows:

§1.1060–1 Special allocation rules for certain asset acquisitions.

(a) * * *

(3) * * *

* * * * *

(e) * * *

(1) * * *

(ii) * * *

(C) Election described in §1.338–6(c)(5).

* * * * *

(c) * * *

(3) *Certain costs.* * * * If an election described in §1.338–6(c)(5) is made with respect to an applicable asset acquisition, any allocation of costs pursuant to this paragraph (c)(3) shall be made as if such election had not been made. The preceding sentence applies to applicable asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007 and on or after September 15, 2004, see §1.1060–1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338–6 and 1.1060–1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

* * * * *

(e) * * *

(1) * * *

(ii) * * *

(C) *Election described in §1.338–6(c)(5)*—*(1) Availability.* The election described in §1.338–6(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(2) Time and manner of making election. The election described in §1.338–6(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(3) Irrevocability of election. The election described in §1.338–6(c)(5) is irrevocable.

(4) Effective/applicability date. This paragraph (e)(1)(ii)(C) applies to applica-

ble asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007 and on or after September 15, 2004, see §1.1060–1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338–6 and 1.1060–1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

* * * * *

§1.1060–1T [Removed]

Par. 6. Section 1.1060–1T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 31, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 11, 2007, 72 F.R. 51703)

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 853.—Foreign Tax Credit Allowed to Shareholders

26 CFR 1.853–1: Foreign tax credit allowed to shareholders.

T.D. 9357

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Elimination of Country-by-Country Reporting to Shareholders of Foreign Taxes Paid by Regulated Investment Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that generally eliminate country-by-country reporting by a regulated investment company (RIC) to its shareholders of foreign source income that the RIC takes into account and foreign taxes that it pays. This change is necessary to conform the regulations to changes in the tax law relating to the foreign tax credit. These final regulations will affect certain RICs that pay foreign taxes and the shareholders of those RICs.

DATES: *Effective Date:* These regulations are effective on August 24, 2007.

Applicability Date: These regulations are applicable for RIC taxable years ending on or after December 31, 2007. For reporting purposes, however, a taxpayer may rely on the current regulations for a taxable year ending on or after December 31, 2007, and beginning before August 24, 2007.

FOR FURTHER INFORMATION CONTACT: Richard C. LaFalce, (202) 622–3930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been

reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2035. Comments on the accuracy of the estimated burden and suggestions for reducing the burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224.

The collection of information in these final regulations is in §1.853–4(c) and (d). A RIC is required to notify the IRS of amounts of income received from sources within foreign countries and possessions of the United States and taxes paid to each such foreign country or possession in order that the IRS may monitor shareholder compliance with the foreign tax credit provisions. The collection of information is required if a RIC elects to pass through the benefits of the foreign tax credit to its shareholders.

Estimated total annual recordkeeping burden: 80 hours.

Estimated average annual burden per recordkeeper: 2 hours.

Estimated number of recordkeepers: 40.

Estimated frequency of recordkeeping: Annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 under section 853 of the Internal Revenue Code (Code). On September 18, 2006, a notice of proposed rulemaking (REG–105248–04, 2006–43 I.R.B. 787) was published in the **Federal Register** (71 FR 54598). Comments were specifically requested with respect to the effective date of the final regulations. In response, a trade association sent a letter requesting that RICs be allowed to rely on the proposed regulations for 2006. This request was not granted. No public hearing was requested or held.

The proposed regulations are adopted by this Treasury decision with minor modifications. The applicability date for these regulations as adopted, balances the industry's desire promptly to eliminate unneeded RIC reporting with the IRS's need for time in which to update its forms and instructions, thereby reducing potential taxpayer confusion that may arise from the new reporting requirements.

Section 853 provides a foreign tax credit or deduction to shareholders of a RIC that makes an election under, and that meets the requirements set forth in, that section. A RIC more than 50 percent of the value of whose total assets at the close of a taxable year consists of stock or securities in foreign corporations may make an election under section 853 (a "foreign tax passthrough election"). If the RIC makes this election for that taxable year, it forgoes a deduction or credit for certain taxes paid to foreign countries and possessions of the United States (collectively, "foreign taxes") (but the amount of the foreign taxes is allowed as an addition to the RIC's deduction for dividends paid for the year). Instead, the RIC passes through to its shareholders a credit or deduction for the foreign taxes it has paid during its taxable year. If the RIC makes this election, each shareholder includes the shareholder's proportionate share of these foreign taxes in gross income and treats this proportionate share as paid by the shareholder. Each shareholder of an electing RIC further treats as gross income from sources within foreign countries and possessions of the United States the sum of the shareholder's proportionate share of these taxes and the portion of any dividend paid by the RIC that represents income derived from sources within foreign countries and possessions of the United States. Each shareholder may then deduct, or claim a credit for the payment of, a proportionate share of these taxes.

A RIC electing this treatment must provide information to its shareholders and to the IRS. First, under section 853(c) of the Code, the RIC must designate, in a written notice mailed to shareholders not later than 60 days after the close of its taxable year, each shareholder's proportionate share of foreign taxes paid by the RIC and each shareholder's proportionate share of the RIC's gross income derived from sources within any foreign country or possession of the United States. Section 1.853–3(a) of the current Income Tax Regulations requires that this notice designate the shareholder's portion of foreign taxes paid to each such foreign country or possession of the United States and the portion of the dividend that represents income derived from sources within each foreign country or possession of the United States.

Second, under current §1.853–4(a), the RIC must file with Form 1099–DIV, "*Dividends and Distributions*," and Form 1096, "*Annual Summary and Transmittal of U.S. Information Returns*," a statement as part of its income tax return (Form 1120–RIC or its successor) that sets forth the total amount of income received from sources within foreign countries and possessions of the United States; the total amount of foreign taxes paid; the date, form, and contents of the notice to its shareholders; and the proportionate share of this income received and these taxes paid during the taxable year attributable to one share of its stock. The RIC must also file as part of its return for the taxable year a Form 1118, "*Foreign Tax Credit—Corporations*," that has been modified so that it is a statement in support of the RIC's foreign tax passthrough election.

The requirement of current §1.853–3(a) that an electing RIC provide country-by-country information to its shareholders on foreign-source income received and foreign taxes paid was adopted at a time when many shareholders generally needed the information to apply a per-country limitation on the foreign tax credit. Because of changes to the foreign tax credit provisions of the Code, shareholders generally no longer need country-by-country information on the amounts of foreign-source income and foreign taxes paid.

The Treasury Department and the IRS have received comments suggesting that the section 853 regulations should be amended to eliminate per-country reporting to shareholders and that Form 1116, "*Foreign Tax Credit (Individual, Estate or Trust)*," should be modified to indicate that distributions from RICs are exempt from per-country shareholder reporting. According to these comments, eliminating the reporting of this information not only would reduce the time and expense required of RICs to compile and disseminate

this tax information but also would reduce the confusion that their shareholders experience upon receipt of the extensive tables used to report this per-country information.

Even though the section 904 foreign tax credit limitation has been applied on a separate-category-of-income basis, instead of on a per-country basis, since 1976, the Treasury Department and the IRS have continued to require the reporting of per-country information by RICs. This per-country information remains relevant to the IRS's monitoring compliance with the section 901 rules that disallow credits for refundable and noncompulsory payments and for taxes paid to certain countries. See §1.901–2(e)(2) and (5), providing that credit is not allowed for amounts that are in excess of final liability under foreign law for tax, and section 901(j), denying credit for tax paid to countries described in section 901(j)(2)(A) and subjecting income from sources in those countries to separate foreign tax credit limitations.

Although per-country information with respect to foreign income and foreign taxes is needed for the IRS to monitor compliance, the Treasury Department and the IRS believe that taxpayer burden can be reduced by continuing to require this information to be supplied with the RIC's tax return but generally not requiring it to be reported to the RIC's shareholders as well. Accordingly, the final regulations revise §1.853–3 and §1.853–4 to require that a RIC provide aggregate per-country information on a statement filed with its tax return and require that only summary foreign income and foreign tax amounts be reported to its shareholders. The instructions to Forms 1116 and 1118 will be modified to permit summary reporting at the shareholder level similar to the summary reporting currently permitted with respect to "section 863(b) income" on Forms 1116 and 1118.

Explanation of Provisions

The final regulations update §1.853–1 to reflect statutory amendments providing that the foreign tax passthrough election is not applicable to taxes for which the RIC would not be allowed a credit by reason of section 901(j) (denying credit for taxes paid to certain countries, including those with which the United States does not have diplomatic relations), section 901(k) and *(l)* (denying credit for withholding taxes paid on certain income where certain holding period requirements are not met), or any similar provision.

The final regulations change in two ways the regulations that set forth requirements for a RIC seeking to make and to notify shareholders of a foreign tax passthrough election:

First, references in §1.853–3(a) and (b) to required statements to shareholders of dollar amounts of taxes paid to specific countries, and to dollar amounts of income considered as received from specific countries, are changed to require that a RIC (or a shareholder of record of the RIC who is a nominee acting as a custodian of a unit investment trust) state only the total amount of the RIC's shareholder's (or the record shareholder nominee's principal's) proportionate share of creditable foreign taxes paid, income from sources within countries described in section 901(j), if any, and income derived from sources within other foreign countries or possessions of the United States.

Second, the final regulations extend various deadlines in §1.853–3(b) to reflect statutory changes since the regulations were issued. Thus the number of days following the close of its taxable year by which a RIC must notify its shareholders in writing of the making of a foreign tax passthrough election is increased to 60. References to the number of days following the close of the taxable year by which a nominee acting as a custodian of a unit investment trust must notify holders of interests in the unit investment trust is increased to 70. Similarly, references to the number of days following the close of a RIC's taxable year by which a statement that holders of interests in unit investment trusts have been directly notified by the RIC (or a statement that the RIC has failed or is unable to notify these holders of interests) must be filed with the IRS and transmitted to a nominee is increased to 60.

Section 1.853–4 is modified to create more flexibility in the references to specific forms. The current regulations require a RIC to file statements with Form 1099 and Form 1096 and to file, as a part of its return for the taxable year, a Form 1118, modified so that it becomes a statement in support of the election made by a RIC to pass through taxes paid to a foreign country or a possession of the United States. The first of these requirements, the requirement to file statements with Forms 1099 and 1096, is eliminated. The final regulations retain the general requirement that a RIC must file as part of its return a statement that elects the application of section 853 for the taxable year.

Section 1.853–4(a) also requires that a RIC agree to provide certain information on foreign-source income received and foreign taxes paid. The information required to be provided is set forth in §1.853–4(c). Section 1.853–4(d) continues to provide that this required information is to be provided on or with a modified Form 1118 but adds that it may instead be provided in such other form or manner as may be prescribed by the Commissioner. This change facilitates future changes in administrative practice if, for example, forms are renumbered or become obsolete.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations because these regulations do not impose a collection of information on small entities.

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. §605(b), it has also been determined that the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations because these regulations do not have a significant economic impact on a substantial number of small entities. According to the Small Business Administration definition of a "small business," 13 C.F.R. 121.201, a RIC is classified as a Portfolio Management company, NAICS code 523920, and is considered a small entity if it accumulates less than 6.5 million dollars in annual receipts. It has been determined that RICs affected by these regulations generally will have greater than 6.5 million dollars in annual receipts and therefore will not generally be classified as small business entities.

Because the summary reporting of the foreign tax credit information provided by these regulations is universally less burdensome than the reporting of country-by-country information previously required, it is also clear that these regulations do not have a significant economic impact on affected RICs. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of this regulation is Richard C. LaFalce of the Office of Associate Chief Counsel (Financial Institutions and Products).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.853–1 also issued under 26 U.S.C. 901(j).

Section 1.853–2 also issued under 26 U.S.C. 901(j).

Section 1.853–3 also issued under 26 U.S.C. 901(j).

Section 1.853–4 also issued under 26 U.S.C. 901(j) and 26 U.S.C. 6011. * * *

Par. 2. Section 1.853–1 is amended by adding a sentence at the end of paragraph (a) and adding paragraph (c) to read as follows:

§1.853–1 Foreign tax credit allowed to shareholders.

(a) *In general.* * * * In addition, the election is not applicable to any tax with respect to which the regulated investment company is not allowed a credit by reason of any provision of the Internal Revenue Code other than section 853(b)(1), including, but not limited to, section 901(j), section 901(k), or section 901(*l*).

* * * * *

(c) *Effective/applicability date.* The final sentence of paragraph (a) of this section is applicable for RIC taxable years ending on or after December 31, 2007.

Par. 3. Section 1.853–2 is amended by revising paragraph (d) and adding paragraph (e) to read as follows:

§1.853–2 Effect of election.

* * * * *

(d) *Example.* This section is illustrated by the following example:

Example. (i) *Facts.* X Corporation, a regulated investment company with 250,000 shares of common stock outstanding, has total assets, at the close of the taxable year, of $10 million ($4 million invested in domestic corporations, $3.5 million in Foreign Country A corporations, and $2.5 million in Foreign Country B corporations). X Corporation received dividend income of $800,000 from the following sources: $300,000 from domestic corporations, $250,000 from Country A corporations, and $250,000 from Country B corporations. All dividends from Country A corporations and from Country B corporations were properly characterized as income from sources without the United States. The dividends from Country A corporations were subject to a 10 percent withholding tax ($25,000) and the dividends from Country B corporations were subject to a 20 percent withholding tax ($50,000). X Corporation's only expenses for the taxable year were $80,000 of operation and management expenses related to both its U.S. and foreign investments. In this case, Corporation X properly apportioned the $80,000 expense based on the relative amounts of its U.S. and foreign source gross income. Thus, $50,000 in expense was apportioned to foreign source income ($80,000 × $500,000/$800,000, total expense times the fraction of foreign dividend income over total dividend income) and $30,000 in expense was apportioned to U.S. source income ($80,000 × $300,000/$800,000, total expense times the fraction of U.S. source dividend income over total dividend income). During the taxable year, X Corporation distributed to its shareholders the entire $645,000 income that was available for distribution ($800,000, less $80,000 in expenses, less $75,000 in foreign taxes withheld).

(ii) *Section 853 election.* X Corporation meets the requirements of section 851 to be considered a RIC for the taxable year and the requirements of section 852(a) for part 1 of subchapter M to apply for the taxable year. X Corporation notifies each shareholder by mail, within the time prescribed by section 853(c), that by reason of the election the shareholders are to treat as foreign taxes paid $0.30 per share of stock ($75,000 of foreign taxes paid, divided by the 250,000 shares of stock outstanding). The shareholders must report as income $2.88 per share ($2.58 of dividends actually received plus the $0.30 representing foreign taxes paid). Of the $2.88 per share, $1.80 per share ($450,000 of foreign source taxable income divided by 250,000 shares) is to be considered as received from foreign sources. The $1.80 consists of $0.30, the foreign taxes treated as paid by the shareholder and $1.50, the portion of the dividends received by the shareholder from the RIC that represents income of the RIC treated as derived from foreign sources ($500,000 of foreign source income, less $50,000 of expense apportioned to foreign source income, less $75,000 of foreign tax withheld, which is $375,000, divided by 250,000 shares).

(e) *Effective/applicability date.* Paragraph (d) of this section is applicable for RIC taxable years ending on or after December 31, 2007. Notwithstanding the preceding sentence, for a taxable year that ends on or after December 31, 2007, and begins before August 24, 2007, a taxpayer may rely on this section as it was in effect on August 23, 2007.

Par. 4. Section 1.853–3 is amended by:

1. Revising paragraph (a).
2. Removing the number "55th" and adding the number "70th" in its place in the first sentence of paragraph (b).
3. Revising the second sentence of paragraph (b).
4. Removing the number "45" and adding the number "60" in its place in each place in which it appears in the fifth sentence of paragraph (b).
5. Adding paragraph (c).

The revisions and addition read as follows:

§1.853–3 Notice to shareholders.

(a) *General rule.* If a regulated investment company makes an election under section 853(a), in the manner provided in §1.853–4, the regulated investment company is required under section 853(c) to furnish its shareholders with a written notice mailed not later than 60 days after the close of its taxable year. The notice must designate the shareholder's portion of creditable foreign taxes paid to foreign countries or possessions of the United States and the portion of the dividend that represents income derived from sources within each country that is attributable to a period during which section 901(j) applies to such country, if any, and the portion of the dividend that represents income derived from other foreign countries and possessions of the United States. For purposes of section 853(b)(2) and §1.853–2(b), the amount that a shareholder may treat as the shareholder's proportionate share of foreign taxes paid and the amount to be included as gross income derived from any foreign country that is attributable to a period during

which section 901(j) applies to such country or gross income from sources within other foreign countries or possessions of the United States shall not exceed the amount so designated by the regulated investment company in such written notice. If, however, the amount designated by the regulated investment company in the notice exceeds the shareholder's proper proportionate share of foreign taxes or gross income from sources within foreign countries or possessions of the United States, the shareholder is limited to the amount correctly ascertained.

(b) * * * The notice shall designate the holder's proportionate share of the amounts of creditable foreign taxes paid to foreign countries or possessions of the United States and the holder's proportionate share of the dividend that represents income derived from sources within each country that is attributable to a period during which section 901(j) applies to such country, if any, and the holder's proportionate share of the dividend that represents income derived from other foreign countries or possessions of the United States shown on the notice received by the nominee pursuant to paragraph (a) of this section. * * *

(c) *Effective/applicability date.* This section is applicable for RIC taxable years ending on or after December 31, 2007. Notwithstanding the preceding sentence, for a taxable year that ends on or after December 31, 2007, and begins before August 24, 2007, a taxpayer may rely on this section as it was in effect on August 23, 2007.

Par. 5. Section 1.853–4 is revised to read as follows:

§1.853–4 Manner of making election.

(a) *General rule.* To make an election under section 853 for a taxable year, a regulated investment company must file a statement of election as part of its Federal income tax return for the taxable year. The statement of election must state that the regulated investment company elects the application of section 853 for the taxable year and agrees to provide the information required by paragraph (c) of this section.

(b) *Irrevocability of the election.* The election shall be made with respect to all foreign taxes described in paragraph (c)(2) of this section, and must be made not later than the time prescribed for filing the return (including extensions). This election, if made, shall be irrevocable with respect to the dividend (or portion thereof), and the foreign taxes paid with respect thereto, to which the election applies.

(c) *Required information.* A regulated investment company making an election under section 853 must provide the following information:

(1) The total amount of taxable income received in the taxable year from sources within foreign countries and possessions of the United States and the amount of taxable income received in the taxable year from sources within each such foreign country or possession.

(2) The total amount of income, war profits, or excess profits taxes (described in section 901(b)(1)) to which the election applies that were paid in the taxable year to such foreign countries or possessions and the amount of such taxes paid to each such foreign country or possession.

(3) The amount of income, war profits, or excess profits taxes paid during the taxable year to which the election does not apply by reason of any provision of the Internal Revenue Code other than section 853(b), including, but not limited to, section 901(j), section 901(k), or section 901(l).

(4) The date, form, and contents of the notice to its shareholders.

(5) The proportionate share of creditable foreign taxes paid to each such foreign country or possession during the taxable year and foreign income received from sources within each such foreign country or possession during the taxable year attributable to one share of stock of the regulated investment company.

(d) *Time and manner of providing information.* The information specified in paragraph (c) of this section must be provided at the time and in the manner prescribed by the Commissioner and, unless otherwise prescribed, must be provided on or with a modified Form 1118 "*Foreign Tax Credit—Corporations*" filed as part of the RIC's timely filed Federal income tax return for the taxable year.

(e) *Effective/applicability date.* This section is applicable for RIC taxable years ending on or after December 31, 2007. Notwithstanding the preceding sentence, for a taxable year that ends on or after December 31, 2007, and begins before August 24, 2007, a taxpayer may rely on this section as it was in effect on August 23, 2007.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (b) is amended by revising the entries for 1.853–3 and 1.853–4 to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified or described	Current OMB control No.
* * * * *	
1.853–3	1545–2035
1.853–4	1545–2035
* * * * *	

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 9, 2007.

Karen G. Sowell,
Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 23, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 24, 2007, 72 F.R. 48551)

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2007.

Rev. Rul. 2007–63

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2007–63 TABLE 1

Applicable Federal Rates (AFR) for October 2007

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.19%	4.15%	4.13%	4.11%
110% AFR	4.62%	4.57%	4.54%	4.53%
120% AFR	5.04%	4.98%	4.95%	4.93%
130% AFR	5.47%	5.40%	5.36%	5.34%
Mid-term				
AFR	4.35%	4.30%	4.28%	4.26%
110% AFR	4.79%	4.73%	4.70%	4.68%
120% AFR	5.23%	5.16%	5.13%	5.11%
130% AFR	5.67%	5.59%	5.55%	5.53%
150% AFR	6.55%	6.45%	6.40%	6.36%
175% AFR	7.67%	7.53%	7.46%	7.41%
Long-term				
AFR	4.88%	4.82%	4.79%	4.77%
110% AFR	5.37%	5.30%	5.27%	5.24%
120% AFR	5.86%	5.78%	5.74%	5.71%
130% AFR	6.37%	6.27%	6.22%	6.19%

REV. RUL. 2007–63 TABLE 2

Adjusted AFR for October 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.60%	3.57%	3.55%	3.54%
Mid-term adjusted AFR	3.79%	3.75%	3.73%	3.72%
Long-term adjusted AFR	4.49%	4.44%	4.42%	4.40%

REV. RUL. 2007–63 TABLE 3

Rates Under Section 382 for October 2007

Adjusted federal long-term rate for the current month	4.49%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.50%

REV. RUL. 2007–63 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 2007

Appropriate percentage for the 70% present value low-income housing credit	8.07%
Appropriate percentage for the 30% present value low-income housing credit	3.46%

REV. RUL. 2007–63 TABLE 5

Rate Under Section 7520 for October 2007

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2007. See Rev. Rul. 2007-63, page 778.

Part III. Administrative, Procedural, and Miscellaneous

2008 Transition Relief and Additional Guidance on the Application of § 409A to Nonqualified Deferred Compensation Plans

Notice 2007–78

I. PURPOSE

This notice provides transition relief and additional guidance on the application of § 409A of the Internal Revenue Code to nonqualified deferred compensation plans. This transition relief and additional guidance includes:

- Extension to December 31, 2008, of the deadline to adopt documents that comply with § 409A, subject to limited requirements regarding the timely written designation of a time and form of payment.
- Guidance and additional relief addressing certain issues raised by the application to employment agreements and cashout features of § 409A and the final regulations.
- Announcement that the Treasury Department and the IRS anticipate issuing guidance containing a limited voluntary compliance program that will permit taxpayers to correct certain unintentional operational violations of § 409A and thereby limit the amount of additional taxes due under § 409A.
- Announcement that the relief from the application of § 409A(b) (which prohibits the use of certain types of arrangements to pay for nonqualified deferred compensation) provided in Notice 2006–33, 2006–1 C.B. 754, with respect to certain "grace period assets", which expires December 31, 2007, is not being extended, so that after December 31, 2007, taxpayers must comply with a reasonable, good faith interpretation of § 409A(b) with respect to all assets in arrangements subject to § 409A(b).

II. BACKGROUND

Section 409A provides certain requirements applicable to nonqualified deferred compensation plans. If a plan does not meet those requirements, participants in the plan are required to immediately include amounts deferred under the plan in income and pay additional taxes on such income.

The Treasury Department and the IRS issued final regulations under § 409A in April 2007 (T.D. 9321, 2007–19 I.R.B. 1123 [72 Fed. Reg. 19234] (April 17, 2007)). The final regulations apply to taxable years beginning on or after January 1, 2008. In general, the final regulations require that the material terms of a nonqualified deferred compensation plan be in writing. See § 1.409A–1(c). Commentators stated that taxpayers anticipate difficulties in formally amending existing plans to comply with the final regulations by the January 1, 2008 deadline. In addition, a number of commentators have raised questions regarding the application of the final regulations to certain types of plans. This notice is issued in response to these comments and questions.

III. 2008 TRANSITION RELIEF

A. In General

Section 409A generally applies to amounts deferred under a nonqualified deferred compensation plan to the extent the amounts deferred under the plan were not earned and vested before January 1, 2005. The final regulations are applicable for taxable years beginning on or after January 1, 2008, and a nonqualified deferred compensation plan must meet the requirements set forth in the final regulations as of the first day of the taxable year. This section provides certain limited transition relief, until December 31, 2008, with respect to the plan document requirements. The transition relief in this notice is not an extension of any of the transition relief provided in Notice 2005–1, 2005–1 C.B. 274, the preamble to the proposed regulations under § 409A, 70 Fed. Reg. 57930 (REG–158080–04, 2005–2 C.B. 786) (Oct. 4, 2005), or Notice 2006–79, 2006–43 I.R.B. 763. Accordingly, except where otherwise provided in the section of the preamble to the final regulations entitled "Effect on Other Documents," taxpayers may not rely upon Notice 2005–1, the proposed regulations, or a reasonable, good faith interpretation of the statute for taxable years beginning on or after January 1, 2008. In addition, after December 31, 2007, taxpayers may not change the time and form of payment except as permitted under the final regulations and this notice, and no change in the time and form of payment after December 31, 2007, may result in an amount that was deferred as of December 31, 2007, qualifying for an exclusion from the definition of deferred compensation under the final regulations. See § 1.409A–1(a)(1).

B. Retroactive Amendment Period

The written provisions of a plan may fail to meet the requirements of § 409A, the final regulations, and any other applicable guidance, because the plan includes a provision that causes the plan to fail to satisfy the requirements of § 409A, or because the plan fails to include a written provision that is required to satisfy the requirements of § 409A. (For purpose of this notice, § 409A, the final regulations, and any other guidance applicable to a plan or a deferred amount is referred to collectively as "the § 409A guidance".) However, under the transition relief provided in this notice, except as otherwise provided in section III.C of this notice addressing the designation of the time and form of payment of deferred amounts, a nonqualified deferred compensation plan will not violate the requirements of § 409A on or before December 31, 2008 merely because the written provisions of the plan fail to meet the requirements of the § 409A guidance, provided that the plan is operated in accordance with the requirements of the § 409A guidance and is amended on or before December 31, 2008 to comply with the § 409A guidance retroactively to January 1, 2008.

A plan is treated as having been amended to comply with the § 409A guidance retroactively to January 1, 2008, only if the written plan, as amended, contains all of the written provisions required by the final regulations and accurately reflects the operation of the plan on and after January 1, 2008, through the date of the amendment, including the terms and conditions under which any initial deferral elections or subsequent deferral elections

were permitted, and how the operation of such plan met the requirements of the § 409A guidance on and after January 1, 2008, through the date of the amendment. For additional guidance related to the adoption of new plans, or the adoption of an amendment to an existing plan increasing amounts deferred under the plan, see § 1.409A–1(c)(3)(i) and (vi).

C. Transition Relief — Designation of a Compliant Time and Form of Payment

This section provides guidelines under which, for periods on or before December 31, 2008, a nonqualified deferred compensation plan will be treated as meeting the requirement to timely designate a time and form of payment of an amount deferred under the plan. Nothing in this section alters the requirement that the plan be operated in accordance with the requirements of the § 409A guidance (including this notice) on and after January 1, 2008, and be amended on or before December 31, 2008, to comply with § 409A and the applicable guidance retroactively to January 1, 2008. For example, nothing in this notice alters the taxpayer's burden to demonstrate that any initial deferral election or subsequent deferral election was made in a manner that complied in operation with the § 409A guidance. In addition, nothing in this section alters the restrictions on changes in the time and form of payment on or before December 31, 2007 under the transition rules set forth in Notice 2005–1, the preamble to the proposed regulations, Notice 2006–79, and the preamble to the final regulations.

1. How to Designate the Time and Form of Payment

Unless a later date is permitted under the final regulations, if there have been deferrals of compensation under a plan as of January 1, 2008, but the deferred compensation has not been paid, the plan will not comply with § 409A after December 31, 2007, unless the plan designates in writing before January 1, 2008, a compliant time and form of payment of such deferred compensation. Amounts deferred after December 31, 2007, and before January 1, 2009, will not comply with § 409A unless the plan designates in writing a compliant time and form of payment of such amounts on or before the applicable deadline under the final regulations (See § 1.409A–2(a) for the rules governing initial deferral elections). For purposes of this section, a plan will designate a compliant time and form of payment of an amount if the written plan terms, disregarding any written plan provisions that do not comply with the § 409A guidance (including this section), provide a compliant time and form of payment as described in section III.C.2 of this notice. For example, if a plan provides for a payment upon a separation from service, but permits the service provider to elect an immediate lump sum payment subject to a forfeiture of a specified portion of the deferred amount (a haircut provision), the haircut provision may be disregarded and the plan will be treated as providing for a payment upon a separation from service, provided the haircut provision is not utilized, and that the haircut provision is removed and the time and form of payment is otherwise fully compliant with the regulations by December 31, 2008. Also, for purposes of this section, a separate written document may be adopted that provides a time and form of payment for amounts deferred under arrangements that are specifically identified (for example, amounts deferred under the Company X Salary Deferral Plan), or that provides a time and form of payment for amounts deferred under arrangements that are not specifically identified (for example, amounts deferred under any arrangement with the service recipient providing the service provider deferred compensation subject to § 409A), or a combination (for example specifying a time and form of payment for amounts deferred under the Company X Salary Deferral Plan, and another time and form of payment for amounts deferred under all other arrangements with the service recipient providing the service provider deferred compensation subject to § 409A), provided that the deferred amounts to which each designated time and form of payment applies are objectively determinable.

2. How to Designate a Compliant Time and Form of Payment

For purposes of this section III.C, a plan will only provide for a compliant time and form of payment for a deferred amount if the plan provides for an objectively determinable form of payment payable upon:

(1) A separation from service;

(2) A change in control event;

(3) An unforeseeable emergency;

(4) A specified date or fixed schedule of payments;

(5) Death; or

(6) Disability.

For example, a plan may provide that an amount deferred under the plan will be paid in the form of a life annuity commencing on the later of the service provider's separation from service or attaining age 65. However, a plan may not provide that an amount deferred under the plan will be paid during the three years following the service provider's separation from service (with the exact timing of the payment during the three-year period determined at the discretion of the service recipient), because that plan term would not provide a compliant time and form of payment. Similarly, a stock option that is subject to § 409A could not provide the service provider the discretion to exercise the stock option over more than one taxable year, because that plan term would not provide a compliant time of payment. See § 1.409A–3(c) for rules on when a plan may designate alternative specified dates or payment schedules with respect to particular payment events.

If the objectively determinable form of payment is a series of installment payments, as defined in § 1.409A–2(b)(2)(iii), the series of installment payments is treated as a single payment unless the plan designates in writing on or before the deadline by which the time and form of payment must be set forth in writing under section III.C.1 of this notice (the section III.C.1 deadline), that the series of installment payments is to be treated as a right to a series of separate payments. On and after the section III.C.1 deadline, the treatment of a series of installment payments as a single payment or as a series of separate payments may not be modified except as permitted under the final regulations.

The plan may specify any combination of payment events that is permissible under the final regulations, including that a deferred amount is to be paid upon the earliest of these events or the latest of these events. However, if a payment event is not specified in writing as a potential payment event on or before the section III.C.1 deadline, the addition of that payment event as a potential payment event is subject to the anti-acceleration provisions under

§ 1.409A–3(j) and the subsequent deferral election provisions under § 1.409A–2(b). For example, a plan providing for the payment of an amount upon the earliest of a service provider's death, disability, or separation from service would provide for a compliant time and form of payment. However, the modification of the provision after the section III.C.1 deadline to provide for the payment of the amount upon the earliest of a service provider's death, disability, or separation from service, or a change in control event, would be an impermissible acceleration of the payment. Similarly, if a payment event is specified in writing on the section III.C.1 deadline as a potential payment event, the removal of the payment event after the applicable deadline as a potential payment event is subject to the anti-acceleration provisions under § 1.409A–3(j) and the subsequent deferral election provisions under § 1.409A–2(b).

3. Retroactive Adoption of Permissible Payment Event Definitions

For purposes of this section, *separation from service* means any event that may qualify as a separation from service under § 1.409A–1(h), *change in control event* means any event that may qualify as a change in control event under § 1.409A–3(i)(5), *unforeseeable emergency* means any event that may qualify as an unforeseeable emergency under § 1.409A–3(i)(3), and *disability* means any event that may qualify as a disability under § 1.409A–3(i)(4). For example, a plan providing only that a payment will be made upon a separation from service (or similar term such as termination of employment) may be treated as providing for a payment upon a separation from service as defined in § 1.409A–1(h). However, the plan must be operated in accordance with the final regulations, so that a payment due upon the service provider's separation from service could only be made upon an event that met the requirements of the definition of separation from service set forth in §1.409A–1(h), and the plan must be amended by December 31, 2008 to accurately reflect the application of the provisions during 2008 and to fully comply with the requirements of the final regulations. Similarly, a plan providing that a payment will be made upon the service provider's disability may be treated as providing for a payment upon a disability as defined in § 1.409A–3(i)(4). However, the plan must be operated in accordance with the final regulations, so that a payment due upon the service provider's disability could only be made upon a disability that met the requirements of the definition of disability set forth in § 1.409A–3(i)(4), and the plan must be amended by December 31, 2008 to accurately reflect the application of the provision during 2008 and to fully comply with the requirements of the final regulations.

For a deferred amount, a plan will not be treated as failing to meet the requirements of § 409A and the final regulations merely because the plan fails to specify in writing the definition of a payment event that is a separation from service, a change in control event, disability, or unforeseeable emergency, applied under the plan on or before December 31, 2008, provided that the definition applied is permissible under the final regulations and the plan is amended on or before December 31, 2008, to accurately reflect the application of the provision during 2008 and to fully comply with the requirements of the final regulations. For example, § 1.409A–1(h)(1)(ii) provides that whether a termination of employment that is a separation from service has occurred is determined based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the level of *bona fide* services the employee would perform after such date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of *bona fide* services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or the full period of services to the employer if the employee has been providing services to the employer for less than 36 months). Section 1.409A–1(h)(1)(ii) further provides that a plan may treat another level of reasonably anticipated permanent reduction in the level of *bona fide* services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of *bona fide* services must be greater than 20% but less than 50% of the average level of *bona fide* services provided in the immediately preceding 36 months. A plan is not required to set forth in writing as of January 1, 2008 whether this alternative definition has been adopted, and may provide that a payment is to be made upon a separation from service of an employee without designating whether the required reduction in the level of services is 20%, 50%, or some other reduction in the level of services available under the final regulations. However, not later than December 31, 2008, the written terms of the plan, including the designation of the payment date, must be both fully compliant with the final regulations and consistent with the application of such designated payment event on and after January 1, 2008.

If a payment event that is a separation from service, a change in control event, an unforeseeable emergency, or a disability, has been timely designated, a later adoption of an alternative definition of the designated payment event, as applicable (or if an alternative definition has been adopted, an adoption of the default definition or another alternative definition), on or before December 31, 2008, will not be treated as a change in the time or form of payment, regardless of whether the adoption of the alternative definition would result in a payment being made at an earlier or later date than under the default definition or the previously designated definition (for example, an alternative definition is adopted during 2007, and a new alternative definition is adopted during 2008). Solely for purposes of effecting the relief provided in this section III.C.3, the availability of a payment to a service provider had the service recipient not been permitted to adopt an alternative definition will not be treated as causing the amount to be includible in income under § 451 or the doctrine of constructive receipt. However, once an event has occurred in 2008 and been treated as a payment event (or as not qualifying as a payment event), the service recipient and service provider may not retroactively alter the definition of the payment event applicable to such deferred amount.

For example, assume that as of December 31, 2007, a plan provided for a deferred amount to be paid as a lump sum payment on or before the 30th day following an employee's separation of service whose level of services for the past 3 years has been 40

hours per week. Assume further that on April 1, 2008, the participating employee (who is not a specified employee) permanently reduces his level of services from 40 hours per week to 10 hours per week. If the amount is paid on or before December 31, 2008, the payment would be consistent with the adoption of a definition of separation from service that is consistent with the requirements of the final regulations for a separation from service, which in this case would be a permanent reduction in the level of services to a level at or below 25% of the level of services previously provided. As of December 31, 2008, the plan would be required to be amended retroactively with respect to that deferred amount to reflect a definition of separation from service consistent with that treatment. In contrast, if the amount is not paid on or before December 31, 2008, the failure to make a payment would be consistent with a definition of separation from service that did not include a reduction in the level of services to a level at or above 25% of the level of services previously provided. As of December 31, 2008, the plan either would be required to apply the default definition of separation from service in the final regulations or would be required to be amended retroactively to reflect a definition of separation from service consistent with that treatment, and any change in the definition of separation from service with respect to such deferred amount after the participating employee's permanent reduction in the level of services on April 1, 2008, would be subject to the anti-acceleration provisions of § 1.409A–3(j) and the subsequent deferral election provisions of § 1.409A–2(b).

4. How to Designate a Specified Payment Date or a Fixed Schedule of Payments

For purposes of section III.C.1, the designation of a specified payment date or a fixed schedule of payments, including the use of a specified payment date or a fixed schedule of payments after a permissible payment event or the lapse of a substantial risk of forfeiture, must meet the requirements of § 1.409A–3(i)(1). Accordingly, the plan must meet the requirements of § 1.409A–3(i)(1) by December 31, 2007, for any amount that will be paid in accordance with:

(1) § 1.409A–3(i)(1)(i) (specified time or fixed schedule in general);

(2) § 1.409A–3(i)(1)(ii) (payment schedules with formula and fixed limitations);

(3) § 1.409A–3(i)(1)(iii) (payment schedules determined by timing of payments received by the service recipient);

(4) § 1.409A–3(i)(1)(iv) (reimbursement or in-kind benefit plans); and

(5) § 1.409A–3(i)(1)(v) (tax gross-up payments)

However, a payment schedule that would otherwise qualify as a fixed schedule of payments under § 1.409A–3(i)(1)(v) (tax gross-up payments), except that the arrangement does not require that the payment be made by the end of the service provider's taxable year next following the service provider's taxable year in which the service provider remits the related taxes, will be treated as designating a fixed schedule of payments if the plan is amended on or before December 31, 2008 to provide for such a requirement, and the plan is operated in compliance with such requirement for periods after December 31, 2007 through the date of the amendment.

In addition, for a specified payment date or a fixed schedule of payments, the addition or deletion of a designated payment provision that meets the requirements of § 1.409A–3(b) or § 1.409A–3(i)(1)(i), as applicable, and does not affect the taxable year in which the payment will be made, is not treated as a change in the time and form of payment if the addition or deletion is made on or before December 31, 2008. For example, if a plan provides for an immediate lump sum payment upon death, the addition of a plan provision on or before December 31, 2008, providing that the payment will be made on or before the end of the service provider's taxable year in which the event occurs will not be treated as a change in the time and form of payment. The addition, deletion or modification of a provision that provides that a payment (including a payment that is part of a schedule) is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs if the designated period is not more than 90 days and the service provider does not have a right to designate the taxable year of the payment (other than an election that complies with the subsequent deferral election rules of § 1.409A–2(b)), also will not be treated as a change in the time and form of payment. For example, if a plan provides that a payment will be made in a lump sum payment upon separation from service, a modification of the plan on or before December 31, 2008, to provide that the payment will be made on or before the 90^{th} day following the separation from service, determined at the sole discretion of the service recipient, is not treated as a change in the time and form of payment. However, plan provisions designating the time and form of payment must be fully compliant with the final regulations as of December 31, 2008.

5. Retroactive Amendments and the Six-Month Delay on Payments to Specified Employees

Section 1.409A–3(i)(2) provides that in the case of any service provider who is a specified employee (as defined in § 1.409A–1(i)) as of the date of a separation from service, the requirements of § 1.409A–1(a)(1) permitting a payment upon a separation from service are satisfied only if payments may not be made before the date that is six months after the date of separation from service (or, if earlier than the end of the six-month period, the date of death of the specified employee). Section 1.409A–1(c)(3)(v) generally requires that the delay requirement be a written provision of any plan providing for a payment upon separation from service to a specified employee. Provided that such payments are delayed in accordance with § 1.409A–1(a)(1), a plan will not be treated as failing to meet the requirements of § 1.409A–1(c)(3)(v) provided that the plan is amended on or before December 31, 2008, retroactively to January 1, 2008, to contain the requirement, and the written plan provision accurately reflects the operation of the plan through the date of the amendment. Taxpayers must demonstrate that the required delay was applied to affected payments. Accordingly, if the service recipient has used any provisions other than the default provisions of § 1.409A–1(i) to identify specified employees, taxpayers must demonstrate the method by which the service recipient identified any specified employees, and that such method of iden-

tifying specified employees was applied consistently to all plans and all service providers.

IV. APPLICATION OF FINAL REGULATIONS AND ADDITIONAL RELIEF

A. Employment Agreements — Good Reason Provisions

Whether a separation from service is involuntary generally is important for the application of the exception from the definition of deferred compensation contained in § 1.409A–1(b)(4) (the short-term deferral rule). Under the short-term deferral rule, an arrangement that provides for a payment within certain limited periods following the lapse of a substantial risk of forfeiture may not constitute deferred compensation. Section 1.409A–1(d) provides that if a service provider's entitlement to an amount is conditioned on the occurrence of the service provider's involuntary separation from service without cause, the right is subject to a substantial risk of forfeiture if the possibility of forfeiture is substantial.

Whether a separation from service is involuntary is also important for the application of the exclusion for certain separation pay arrangements under § 1.409A–1(b)(9). That provision excludes from deferred compensation a right to certain amounts that are payable within a limited period of time following an involuntary separation from service, and is available only if the amounts are payable upon an involuntary separation from service (often referred to as the "two-year, two-time rule").

Section 1.409A–1(n) provides a definition of an involuntary separation from service. Section 1.409A–1(n)(2)(i) provides that as a general rule a service provider's voluntary separation from service will be treated as an involuntary separation from service if the separation from service occurs under certain limited *bona fide* conditions, where the avoidance of the requirements of § 409A is not a purpose of the inclusion of these conditions in the plan or of the actions by the service recipient in connection with the satisfaction of these conditions, and a voluntary separation from service under such conditions effectively constitutes an involuntary separation from service. Section 1.409A–1(n)(2)(ii) contains a safe harbor setting forth a set of conditions often referred to as the "safe harbor good reason conditions". The safe harbor states that if a plan provides that a voluntary separation from service will be treated as an involuntary separation from service if the separation from service occurs under certain express conditions, a separation from service satisfying the conditions set forth in the plan will be treated as an involuntary separation from service if the necessary conditions (or set of conditions) satisfy the requirements of the regulations.

Commentators have stated that to ensure qualification for one or both of the short-term deferral rule or the two-year, two-time rule, taxpayers have considered modifying employment arrangements that currently provide for a payment upon a voluntary separation from service under certain conditions (often referred to as "good reason conditions"), including modifying the good reason conditions under which an employee could voluntarily terminate employment and receive payments. Some taxpayers want to replace the existing good reason conditions in their agreements with a set of safe harbor good reason conditions qualifying under § 1.409A–1(n)(2)(ii). Other taxpayers want to add only some of the safe harbor good reason conditions (for example, adding a requirement that the employee provide notice to the employer that the good reason condition has been satisfied). Other taxpayers have proposed removing a condition from an existing agreement, because the condition is not a condition found in the good reason safe harbor.

The modification of these arrangements raises issues regarding whether a substantial risk of forfeiture condition has been added or modified in a manner that would not be respected under Notice 2005–1, Q&A–10, proposed § 1.409A–1(d) or final § 1.409A–1(d). Notice 2005–1, Q&A–10 provides that any addition of a substantial risk of forfeiture after the beginning of the service period to which the compensation relates, or any extension of a period during which compensation is subject to a substantial risk of forfeiture, in either case whether elected by the service provider, service recipient or other person (or by agreement of two or more of such persons), is disregarded for purposes of determining whether such compensation is subject to a substantial risk of forfeiture. See also proposed and final § 1.409A–1(d).

The Treasury Department and the IRS understand that taxpayers may desire to conform existing good reason conditions to the requirements of the definition of an involuntary separation from service under the regulations. Accordingly, to the extent that a right to a payment subject to an existing good reason condition is subject to a substantial risk of forfeiture, the modification of the good reason condition on or before December 31, 2007 to conform to some or all of the conditions set forth in § 1.409A–1(n)(2) will not be treated as an extension of the substantial risk of forfeiture. However, if the right to a payment subject to existing good reason conditions is not subject to a substantial risk of forfeiture, the modification of such condition to include one or more of the conditions set forth in § 1.409A–1(n)(2)(ii), or to remove one or more of the existing good reason conditions, will not cause the amount to be treated as subject to a substantial risk of forfeiture.

As provided by Notice 2006–79, for amounts subject to § 409A, a plan may provide, or be amended to provide, for new payment elections on or before December 31, 2007, with respect to both the time and form of payment of such amounts and the election or amendment will not be treated as a change in the time or form of payment under § 409A(a)(4) or an acceleration of a payment under § 409A(a)(3), provided that the plan is so amended and elections are made on or before December 31, 2007. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2007, and on or before December 31, 2007, the election or amendment may apply only to amounts that would not otherwise be payable in 2007 and may not cause an amount to be paid in 2007 that would not otherwise be payable in 2007. An election of a new time and form of payment under these transition rules may cause an amount to be excluded from coverage under § 409A. In the case of a right to a payment of deferred compensation, the modification of the time and form of the payment such that the payment will only be made upon an involuntary separation from service may result in the exclusion of such right, or a portion of such right, from the definition of deferred compensation under § 1.409A–1(b)(9) (the

two-year, two-time rule), to the extent the amended arrangement otherwise met the requirements for the exclusion. In modifying the arrangement, however, taxpayers should ensure that the amendment does not affect amounts that otherwise would be payable in 2007 (for example, because a separation from service occurred during 2007).

B. Employment Agreements — Application of Substitution Rule

Commentators have asked about the conditions under which rights to deferred compensation under an extension of an employment agreement, or a negotiation of a new employment agreement, will constitute a new legally binding right to compensation rather than a substitution for rights to deferred compensation contained under a previous agreement. Until further guidance, if a right to deferred compensation payable only upon an involuntary separation from service (as defined under § 1.409A–1(n)) at all times under an employment agreement would automatically be forfeited at the end of the term of the employment agreement, then the grant of a right to deferred compensation in an extended, renewed or renegotiated employment agreement will not be treated as a substitute for the right that was forfeited at the termination of the prior employment agreement. For example, if an employment agreement at all times provides that an employee has a right to deferred compensation if the employee is involuntarily separated from service without cause during the three-year term of the employment agreement, but that deferred compensation will become payable at the end of the original three-year term of the employment agreement if the employee is available to perform services and the employer does not extend, renew, or replace the employment agreement, and at the end of the three-year term of the employment agreement the employee has not been involuntarily separated, the right to deferred compensation in a renewed, extended or renegotiated employment agreement may be viewed as a substitute for the right to deferred compensation in the original agreement. However, if the employment agreement had not provided that any deferred compensation would become payable at the end of the original three-year term of the employment agreement if the employee had been available to perform services and the employer had not extended, renewed or replaced the employment agreement, and the employee had not been involuntarily separated during the three-year term of the employment agreement, then a right to deferred compensation under an employment agreement covering services after the end of the original three-year term would not be treated as a substitute for the right to the deferred compensation upon an involuntary separation from service during the original three-year term.

C. Predetermined Cashouts

Section 1.409A–2(b)(2)(iii) provides a limited ability to provide for the cashout of all remaining installments under an installment payment provision when the present value of the remaining payments falls below the predetermined threshold. Section 1.409A–2(b)(2)(ii) provides a similar rule with respect to annuity payments.

Commentators asked whether a plan may provide for a lump sum payment at the payment date only if the present value of the payments at that date is below a predetermined amount, but continue to make any properly elected installment payments or annuity payments if the present value of the payments at the original payment date is above the predetermined amount, even if the present value of the remaining payments falls below the predetermined amount at a future date. In other words, the cashout threshold would apply only at the time of the original payment date, and not at any future date.

Section 1.409A–2(b)(2)(ii) and (iii) does not provide for this type of payment. However, commentators have asked whether such a provision would be treated as an objective, nondiscretionary payment formula for purposes of § 1.409A–3(b). Section 1.409A–3(b) provides that a plan may provide that a payment upon a qualifying payment event is to be made in accordance with a schedule that is objectively determinable and nondiscretionary based on the date the event occurs and that would qualify as a fixed schedule under § 1.409A–2(i)(1) if the payment event were instead a fixed date, provided that the schedule must be fixed at the time the permissible payment event is designated.

The use of this type of a cashout provision may, in certain circumstances, be subject to manipulation, so that this type of provision is not an objectively determinable and nondiscretionary schedule of payments. However, until further guidance, a taxpayer may treat such a provision as part of an objectively determinable and nondiscretionary payment schedule if the payment schedule would otherwise meet the requirements of the regulations, including that the cashout threshhold be fixed at the time the permissible payment event is designated, and if the taxpayer can demonstrate that the provision operated in an objective, nondiscretionary manner and did not operate so as to provide either the service provider or the service recipient with rights having substantially the effect of a right to a late election as to the time and form of payment. Any subsequent change in a cashout threshold applicable to a deferred amount is subject to the rules governing subsequent deferral elections and the acceleration of payments.

If such a provision is used in conjunction with an installment payment or annuity, the payment schedule generally would not meet the definition of an installment payment or annuity under § 1.409A–2(b)(2)(ii) and (iii), because the payment schedule would not necessarily provide for substantially equal payments over the service provider's lifetime or other predetermined period of time, but instead a lump sum payment if the threshold were not met and periodic payments if the threshold were met. However, until further guidance, the classification of the resulting schedule of payments if the cashout threshold is exceeded at the applicable payment date, whether or not such schedule of payments is intended to be an installment payment or life annuity, is determined as if the lump sum payment cashout threshold were not available. Accordingly, the resulting schedule of payments if the threshold is met must otherwise meet the requirements of § 1.409A–3, and if the resulting schedule of payments qualifies as a life annuity under § 1.409A–2(b)(ii), or as a series of installment payments treated as a single payment under § 1.409A–2(b)(2)(iii), the schedule of payments will be treated as a single payment for purposes of the subsequent deferral rules.

V. ANTICIPATED LIMITED VOLUNTARY COMPLIANCE PROGRAM

The Treasury Department and the IRS anticipate issuing guidance in the near future establishing a limited voluntary compliance program that will apply to certain unintentional operational failures to comply with § 409A. The Treasury Department and the IRS anticipate that such guidance will provide methods by which certain unintentional operational failures may be corrected in the same taxable year in which the operational failure occurred to avoid application of § 409A, and other methods by which certain unintentional operational failures may result in only limited amounts becoming includible in income and subject to additional taxes under § 409A.

VI. APPLICATION OF § 409A(b) (RESTRICTIONS ON CERTAIN TRUSTS AND OTHER ARRANGEMENTS)

Section 409A(b)(1) and (2) generally prohibits the use of offshore trusts in connection with amounts payable under a nonqualified deferred compensation plan, and also prohibits the use of restrictions on assets to protect the payment of benefits under a nonqualified deferred compensation plan in connection with a change in the service recipient's financial health. Section 409A(b)(3) generally also prohibits the transfer of assets to a trust or other arrangement for purposes of paying nonqualified deferred compensation to an applicable covered employee during, or the use of restrictions on assets to protect the payment of benefits under a nonqualified deferred compensation plan in connection with, a restricted period with respect to a single-employer defined benefit plan. For this purpose, a restricted period with respect to a single-employer defined benefit plan generally means any period during which the plan is in at-risk status (as defined in § 430(i), which was added by the Pension Protection Act of 2006), any period the plan sponsor is a debtor in a bankruptcy filing, and the 12-month period beginning on the date which is 6 months before the termination of the defined benefit plan if, as of the termination date, the plan is underfunded. Section 409A(b) provides generally that if these requirements are not met, the assets are treated for purposes of § 83 as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors, and that the taxpayer is liable for the additional § 409A taxes on the resulting income inclusion.

Notice 2006–33 provides that until further guidance is issued, taxpayers may rely upon a reasonable, good faith interpretation of § 409A(b) to determine whether the use of a trust or other arrangement causes an amount to be included in income under § 409A(b). The Treasury Department and the IRS intend to issue further guidance regarding the application of § 409A(b). Until such guidance is issued, taxpayers may continue to rely upon a reasonable, good faith interpretation of § 409A(b) to determine whether the use of a trust or other arrangement causes an amount to be included in income under § 409A(b), including the application of § 409A(b)(3) to transfers of assets during restricted periods.

Notice 2006–33 also provides that with respect to assets set aside, transferred or restricted on or before March 21, 2006 so as to be subject to inclusion under § 409A(b)(1) or 409A(b)(2) (grace period assets), taxpayers will be treated as not having triggered the inclusion or additional tax provisions of § 409A(b) if the nonqualified deferred compensation plan comes into conformity on or before December 31, 2007, with the requirements of § 409A(b) and any guidance issued before such date. Nothing in this section curtails this relief; however, this relief is not extended beyond December 31, 2007. Accordingly, for grace period assets, a taxpayer will trigger the income inclusion and additional tax provisions of § 409A(b) if the nonqualified deferred compensation plan is not in conformity with a reasonable, good faith interpretation of § 409A(b) on or after December 31, 2007. If with respect to grace period assets the nonqualified deferred compensation plan is not in conformity with a reasonable, good faith interpretation of § 409A(b) on December 31, 2007, the taxpayer will trigger the income inclusion and additional tax provisions of § 409A(b) on January 1, 2008.

VII. DRAFTING INFORMATION

The principal author of this notice is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Stephen Tackney at (202) 927–9639 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 1361, 1362; 1.1361–1, 1.1361–3, 1.1362–4, 1.1362–6, 301.9100–1, 301.9100–3.)

Rev. Proc. 2007–62

SECTION 1. PURPOSE

This revenue procedure provides an additional simplified method for taxpayers to request relief for late S corporation elections and supplements Rev. Proc. 2003–43, 2003–1 C.B. 998. In addition, this revenue procedure provides a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election intended to be effective on the same date that the S corporation election was intended to be effective and supplements Rev. Proc. 2004–48, 2004–2, C.B. 172. Generally, this revenue procedure provides that certain eligible entities may be granted relief if the entity satisfies the requirements of sections 4 or 5 (as applicable) of this revenue procedure.

SECTION 2. BACKGROUND

.01 *S Corporation Elections.*

(1) *In General.* Section 1361(a)(1) of the Internal Revenue Code (Code) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for that year.

Section 1362(b)(1) provides that a small business corporation may make an election to be an S corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before

the 15th day of the 3rd month of the taxable year. Section 1.1362–6(a)(2) of the Income Tax Regulations provides that a small business corporation makes an election to be an S corporation by filing a completed Form 2553, *Election by a Small Business Corporation.*

Under § 1362(b)(3), if an S corporation election is made after the 15th day of the 3rd month of the taxable year and on or before the 15th day of the 3rd month of the following taxable year, then the S corporation election is treated as made for the following taxable year.

(2) *Late S Corporation Elections.* Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Rev. Proc. 97–48, 1997–2 C.B. 521 provides special procedures to obtain automatic relief for certain late S corporation elections. Generally, relief is available in situations in which a corporation intends to be an S corporation, the corporation and its shareholders reported their income consistent with S corporation status for the taxable year the S corporation election should have been made and for every subsequent year, and the corporation did not receive notification from the Internal Revenue Service regarding any problem with the S corporation status within 6 months of the date on which the Form 1120S, *U.S. Income Tax Return for an S Corporation*, for the first year was timely filed.

Rev. Proc. 2003–43 provides, in part, a simplified method for a taxpayer to request relief for a late S corporation election where the entity fails to qualify as an S corporation solely because of the failure to file the election timely with the applicable campus. Under the revenue procedure, certain entities may be granted relief for failing to file the elections in a timely manner if the request for relief is filed within 24 months of the due date of the election.

.02 *Entity Classification Elections.*

(1) *In General.* Section 301.7701–2(a) of the Procedure and Administration Regulations defines a "business entity" as any entity recognized for federal tax purposes that is not properly classified as a trust under § 301.7701–4 or otherwise subject to special treatment under the Code.

Section 301.7701–3(a) provides that a business entity that is not classified as a corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7), or (8) (an "eligible entity") can elect its classification for federal tax purposes.

Section 301.7701–3(b)(1) provides that, except as otherwise provided in paragraph (b)(3) of the section, unless the entity elects otherwise, a domestic eligible entity is (i) a partnership if it has two or more members; or (ii) disregarded as an entity separate from its owner if it has a single owner.

Section 301.7701–3(c)(1) provides that, except as provided in § 301.7701–3(c)(1)(iv) and (v), an eligible entity may elect to be classified other than as provided in § 301.7701–3(b) by filing Form 8832, *Entity Classification Election*, with the campus designated on Form 8832.

Section 301.7701–3(c)(iii) provides that the entity classification election will be effective on the date specified by the entity on the Form 8832 or on the date filed if no date is specified on the election form. The effective date specified on Form 8832 can not be more than 75 days prior to the date on which the election is filed and can not be more than 12 months after the date on which the election is filed. If an election specifies an effective date more than 75 days prior to the date on which the election is filed, the election will be effective 75 days prior to the date it was filed. If an election specifies an effective date more than 12 months from the date on which the election is filed, the election will be effective 12 months after the date the election was filed.

(2) *Late Entity Classification Elections.* Under § 301.9100–1(c), the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100–2 and 301.9100–3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code, except subtitles E, G, H, and I.

Section 301.9100–1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

Requests for relief under § 301.9100–3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Rev. Proc. 2002–59, 2002–2 C.B. 615, provides guidance for an entity newly formed under local law that requests relief for a late initial classification election filed by the due date of the entity's first federal income tax return (excluding extensions).

Under § 301.7701–3(c)(1)(v)(C), an eligible entity that timely elects to be an S corporation under § 1362(a)(1) is treated as having made an election to be classified as an association, provided that (as of the effective date of the election under § 1362(a)(1)) the entity meets all other requirements to qualify as a small business corporation under § 1361(b). Section 301.7701–3(c)(1)(v)(C) further provides that, subject to § 301.7701–3(c)(1)(iv), the deemed election to be classified as an association generally will apply as of the effective date of the S corporation election and will remain in effect until the entity makes a valid election under § 301.7701–3(c)(1)(i), to be classified as other than an association.

Rev. Proc. 2004–48 provides a simplified method for taxpayers to request relief for a late S corporation election and a late corporate classification election which was intended to be effective on the same date the S corporation election was intended to be effective. Under Rev. Proc. 2004–48, generally, certain eligible entities may be granted relief if the requirements of section 4 of the revenue procedure are satisfied. To obtain relief under Rev. Proc. 2004–48, the entity must file a properly completed Form 2553 with the applicable campus within 6 months after the due date for the tax return, excluding extensions, for the first taxable year the entity intended to be an S corporation. Attached to the Form 2553 must be a statement explaining the reason for the failure to file timely the S corporation election and

a statement explaining the reason for the failure to file timely the entity classification election.

SECTION 3. SCOPE

.01 *In General.* This revenue procedure supplements Rev. Proc. 2003–43 and provides an additional simplified method for obtaining relief for a late S corporation election, provided that the requirements of section 4 of this revenue procedure are satisfied. This revenue procedure also supplements Rev. Proc. 2004–48 and provides an additional simplified method for obtaining relief for a late S corporation election and a late corporate classification election, provided that the requirements of section 5 of this revenue procedure are satisfied.

Section 4.01 of this revenue procedure provides the eligibility requirements for relief for a late S corporation election, and section 4.02 of this revenue procedure provides the procedural requirements for relief. Section 5.01 of this revenue procedure provides the eligibility requirements for relief for a late S corporation election and a late corporate classification election, and section 5.02 of this revenue procedure provides the procedural requirements for relief.

This revenue procedure provides procedures in lieu of the letter ruling process ordinarily used to obtain relief for a late S corporation election and a late corporate classification election filed pursuant to § 1362(b)(5), § 301.9100–1 and § 301.9100–3. Accordingly, user fees do not apply to corrective actions under this revenue procedure.

.02 *Entities That Fail to Qualify for Relief Under This Revenue Procedure.*

(1) *Rev. Procs. 97–48, 2003–43, and 2004–48.* An entity that does not meet the requirements for relief under this revenue procedure may request relief for a late S corporation election following the procedures of Rev. Proc. 97–48, or Rev. Proc. 2003–43, or, for relief for a late S corporation election and a late corporate classification election following the procedures of Rev. Proc. 2004–48.

(2) *Letter Rulings.* If an entity does not qualify for relief for a late S corporation election, or relief for a late S corporation election and a late corporate classification election, under Rev. Proc. 97–48, Rev. Proc. 2003–43, or Rev. Proc. 2004–48, as appropriate, the entity may request relief by requesting a letter ruling. The Service will not ordinarily issue a letter ruling if the period of limitations on assessment under § 6501(a) has lapsed for any taxable year for which an election should have been made or any taxable year that would have been affected by the election had it been timely made. The procedural requirements for requesting a letter ruling are described in Rev. Proc. 2007–1, 2007–1 I.R.B. 1 (or its successor).

SECTION 4. RELIEF FOR LATE S CORPORATION ELECTION UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Relief.* An entity may request relief under this revenue procedure if the following requirements are met:

(1) The entity fails to qualify for its intended status as an S corporation on the first day that status was desired solely because of the failure to file a timely Form 2553 with the applicable campus;

(2) The entity has reasonable cause for its failure to file a timely Form 2553;

(3) The entity seeking to make the S corporation election has not filed a tax return for the first taxable year in which the election was intended;

(4) The application for relief is filed under this revenue procedure no later than 6 months after the due date of the tax return (excluding extensions) of the entity seeking to make the election for the first taxable year in which the election was intended; and

(5) No taxpayer whose tax liability or tax return would be affected by the S corporation election (including all shareholders of the S corporation) has reported inconsistently with the S corporation election, on any affected return for the year the S corporation election was intended.

.02 *Procedural Requirements for Relief.*

An entity may request relief for a late S corporation election by filing with the applicable campus a properly completed Form 2553 (*see* Form 2553 and Instructions) with a Form 1120S for the first taxable year the entity intended to be an S corporation. A properly completed Form 2553 includes a statement establishing reasonable cause for the failure to file the S corporation election timely. The Form 2553 will be modified to allow for the inclusion of such statement. The forms must be filed together no later than 6 months after the due date of the tax return (excluding extensions) of the entity for the first taxable year in which the S corporation election was intended. These items constitute the application requesting relief.

.03 *Relief for Late S Corporation Election.* Upon receipt of a completed application requesting relief under section 4.02 of this revenue procedure, the Service will determine whether the requirements for granting relief for the late S corporation election have been satisfied.

SECTION 5. RELIEF FOR LATE S CORPORATION ELECTION AND LATE CORPORATE CLASSIFICATION ELECTION UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Relief.* An entity may request relief under this revenue procedure if the following requirements are met:

(1) The entity is an eligible entity as defined in § 301.7701–3(a);

(2) The entity intended to be classified as a corporation as of the intended effective date of the S corporation status;

(3) The entity fails to qualify as a corporation solely because Form 8832 was not timely filed under § 301.7701–3(c)(1)(i), or Form 8832 was not deemed to have been filed under § 301.7701–3(c)(1)(v)(C);

(4) In addition to section 5.01(3) of this section, the entity fails to qualify as an S corporation on the intended effective date of the S corporation status solely because the S corporation election was not timely filed pursuant to § 1362(b);

(5) The entity has reasonable cause for its failure to file a timely Form 2553 and a timely Form 8832;

(6) The entity seeking to make the S corporation election has not filed a tax return for the first taxable year in which the election was intended;

(7) The application for relief is filed under this revenue procedure no later than 6 months after the due date of the S corporation return (excluding extensions) of the entity seeking to make the election for the first taxable year in which the election was intended, and

(8) No taxpayer whose tax liability or tax return would be affected by the S cor-

poration election (including all shareholders of the S corporation) has reported inconsistently with the S corporation election, on any affected return for the year the S corporation election was intended.

.02 *Procedural Requirements for Relief.*

An entity may request relief for a late S corporation election and a late corporate classification election by filing a properly completed Form 2553 (*see* Form 2553 and Instructions) with a Form 1120S for the first taxable year the entity intended to be an S corporation. A properly completed Form 2553 includes a statement explaining the reason for the failure to file the S corporation election timely and a statement explaining the reason for the failure to file the entity classification election timely. The Form 2553 will be modified to allow for the inclusion of such statements. The forms must be filed together no later than 6 months after the due date of the tax return (excluding extensions) of the entity for the first taxable year in which the S corporation election was intended. These items constitute the application requesting relief.

.03 *Relief for Late S Corporation Election and Late Corporate Classification Election.* Upon receipt of a completed application requesting relief under section 5.02 of this revenue procedure, the Service will determine whether the requirements for granting relief for the late S corporation election and late corporate classification election have been satisfied. An entity receiving relief under this revenue procedure is treated as having made an election to be classified as an association taxable as a corporation under § 301.7701–3(c) as of the effective date of the S corporation election.

SECTION 6. EFFECT ON OTHER DOCUMENTS

This revenue procedure supplements Rev. Procs. 2003–43 and 2004–48.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for S corporation elections and corporate classification elections intended to be effective for taxable years that end on or after December 31, 2007.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Jian H. Grant of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ms. Grant at (202) 622–3050 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Regulations and Notice of Public Hearing

Partner's Distributive Share

REG–143397–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed regulations and notice of public hearing.

SUMMARY: This document contains regulations that provide rules concerning the application of sections 704(c)(1)(B) and 737 to distributions of property after two partnerships engage in an assets-over merger. The proposed regulations affect partnerships and their partners. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 20, 2007. Outlines of the topic to be discussed at the public hearing scheduled for December 5, 2007 at 10 a.m. must be received by November 21, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–143397–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered Monday through Friday, between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–143397–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–143397–05). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jason Smyczek or Laura Fields (202) 622–3050, concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, *Richard.A.Hurst@irscounsel.treas.gov*, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 704(c)(1)(B) provides that a partner that contributes section 704(c) property to a partnership must recognize gain or loss on the distribution of such property to another partner within seven years of its contribution to the partnership in an amount equal to the gain or loss that would have been allocated to such partner under section 704(c) if the distributed property had been sold by the partnership to the distributee partner for its fair market value at the time of the distribution.

Section 737(a) provides that a partner that contributes section 704(c) property to the partnership and then receives a distribution of property (other than money) within seven years of its contribution must recognize gain in an amount equal to the lesser of (1) the excess (if any) of (A) the fair market value of property (other than money) received in the distribution over (B) the adjusted basis of the partner's interest in the partnership immediately before the distribution reduced (but not below zero) by the amount of money received in the distribution, or (2) the net precontribution gain of the partner.

Section 737(b) provides that for purposes of section 737, the term "net precontribution gain" means the net gain (if any) which would have been recognized by the distributee partner under section 704(c)(1)(B) if all property which (1) had been contributed to the partnership by the distributee partner within seven years of the distribution, and (2) is held by the partnership immediately before the distribution, had been distributed by the partnership to another partner.

Rev. Rul. 2004–43, 2004–1 C.B. 842, (see §601.601(d)(2) of this chapter) issued on April 12, 2004, addressed the application of sections 704(c)(1)(B) and 737 in an assets-over partnership merger described in §1.708–1(c)(3). Rev. Rul. 2004–43 held that section 704(c)(1)(B) applies to newly created section 704(c) gain or loss in property contributed by the transferor partnership to the transferee partnership in an assets-over partnership merger. The revenue ruling also held that for purposes of section 737(b), net precontribution gain includes newly created section 704(c) gain or loss in property contributed by the transferor partnership to the transferee partnership in an assets-over partnership merger. In addition, the revenue ruling held that section 704(c)(1)(B) will not apply to, and, for purposes of section 737, net precontribution gain will not include, reverse section 704(c) gain or loss resulting from a revaluation of property of the transferee partnership.

Some commentators argued that Rev. Rul. 2004–43 was not consistent with the existing regulations under sections 704(c)(1)(B) and 737, and that the conclusions contained in the ruling should not be applied retroactively. In response to these comments, the Treasury Department and the IRS issued Notice 2005–15, 2005–1 C.B. 527, (see §601.601(d)(2) of this chapter) indicating their intent to issue regulations under sections 704(c)(1)(B) and 737 implementing the principles of the ruling, and issued Rev. Rul. 2005–10, 2005–1 C.B. 492, (see §601.601(d)(2) of this chapter) officially revoking Rev. Rul. 2004–43. The notice provided that any such regulations would be effective for distributions made after January 19, 2005.

Explanation of Provisions

A. Assets-Over Partnership Mergers

These proposed regulations implement the principles articulated in Rev. Rul. 2004–43. The proposed regulations under §1.704–4(c)(4) and §1.737–2(b) provide that in an assets-over merger, sections 704(c)(1)(B) and 737 do not apply to the transfer by a partnership (the transferor partnership) of all of its assets and liabilities to another partnership (the transferee partnership), followed by a distribution of the interests in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement.

The proposed regulations, however, provide that section 704(c)(1)(B) applies to a subsequent distribution by the transferee partnership of section 704(c) property contributed in the assets-over merger by the transferor partnership to

the transferee partnership. The proposed regulations also provide that section 737 applies when a partner of the transferor partnership receives a subsequent distribution of property (other than money) from the transferee partnership.

The proposed regulations provide that for property contributed to the transferor partnership (original contribution), the amount of original section 704(c) gain or loss is the difference between the property's fair market value and the contributing partner's adjusted basis at the time of contribution to the extent such difference has not been eliminated by section 704(c) allocations, prior revaluations, or in connection with the merger. In the case of property contributed with original section 704(c) loss, section 704(c)(1)(C) which was added by the American Jobs Creation Act of 2004 provides special rules for determining the basis of the property contributed. The Treasury Department and IRS are currently developing guidance that will implement the provisions of section 704(c)(1)(C). Thus, the proposed regulations do not address the impact of section 704(c)(1)(C) in applying these rules. However, when finalized, these regulations will clarify the application of section 704(c)(1)(C) to these rules.

The proposed regulations provide that the seven year period will not restart with respect to the original section 704(c) gain or loss as a result of the merger. Accordingly, a subsequent distribution by the transferee partnership of property with original section 704(c) gain or loss is subject to sections 704(c)(1)(B) and 737 if the distribution occurs within seven years of the contribution of the property to the transferor partnership (original contribution). However, with respect to new section 704(c) gain or loss, the regulations provide that the seven-year period in sections 704(c)(1)(B) and 737 begins on the date of merger. Thus, a subsequent distribution by the transferee partnership of property with new section 704(c) gain or loss is subject to sections 704(c)(1)(B) and 737 if the distribution occurs within seven years of the merger.

The regulations further provide that no original section 704(c) gain or loss will be recognized under section 704(c)(1)(B) or section 737 if property that was originally contributed to the transferor partnership is distributed to the original contributor. If property has new section 704(c) gain or loss, then a subsequent distribution of such property within seven years of the merger to one of the former partners of the transferor partnership (former partner) is subject to section 704(c)(1)(B) only to the extent of the other former partners' shares of such gain or loss.

New section 704(c) gain or loss shall be allocated among the partners of the transferor partnership in a manner consistent with the principles of §§1.704–3(a)(7) and newly designated 1.704–3(a)(10) (previously §1.704–3(a)(9)). In addition, the partners of the transferor partnership are deemed to have contributed an undivided interest in the assets of the partnership. The proposed regulations provide that the determination of the partners' undivided interest for this purpose shall be made by the transferor partnership using any reasonable method. The Treasury Department and the IRS request comments on methods that should be considered reasonable for this purpose.

The proposed regulations also provide that if less than all of a section 704(c) property is distributed, then a proportionate amount of original and new section 704(c) gain or loss must be recognized under section 704(c)(1)(B). Similarly, if gain is required to be recognized under section 737, a proportionate amount of original and new section 704(c) gain must be recognized under section 737. Each partner must recognize its respective proportionate share of gain or loss required to be recognized.

The proposed regulations further provide a subsequent merger rule. This rule provides that if the transferee partnership is subsequently merged (a subsequent merger) the new section 704(c) gain or loss that resulted from the original merger shall be subject to section 704(c)(1)(B) for seven years from the time of the original merger and the new section 704(c) gain or loss that resulted from the subsequent merger will be subject to section 704(c)(1)(B) for seven years from the time of the subsequent merger.

In addition, the proposed regulations provide an identical ownership and a *de minimis* change in ownership exception to sections 704(c)(1)(B) and 737 with regard to assets-over partnership mergers. Under the identical ownership exception, section 704(c)(1)(B) will not apply to, and section 737 net precontribution gain will not include, new section 704(c) gain or loss in any property contributed in an assets-over partnership merger where the ownership of both partnerships is identical. In order for merging partnerships to qualify for the identical ownership exception, each partner must own identical interests in book capital and in each item of income, gain, loss, deductions and credit, and identical shares of distributions and liabilities in each of the transferor and transferee partnerships. Where ownership of both partnerships is identical, the merger more accurately represents a change in form, and should have no substantive tax consequences. The same principles apply where the change in ownership is *de minimis*. For purposes of the *de minimis* exception, a difference in ownership is *de minimis* if ninety seven percent of the interests in book capital, items of income, gain, loss, deduction and credit and share of distributions and liabilities of the transferor partnership and transferee partnership are owned by the same owners in the same proportions.

Proposed regulations under §1.704–3(c)(4)(iii) provide that taxpayers may distinguish between the original and new portions of section 704(c) gain or loss. The proposed regulations provide that the transferee partnership may continue to use the section 704(c) allocation method adopted by the transferor partnership with respect to original section 704(c) property, or it may adopt another reasonable section 704(c) method. In addition, the transferee partnership may adopt any reasonable section 704(c) method with respect to new section 704(c) gain or loss. With respect to both the original and the new section 704(c) gain or loss, the transferee partnership must use a reasonable method that is consistent with the purpose of sections 704(b) and 704(c).

B. Miscellaneous Provisions

As part of this proposed regulation, the Treasury Department and the IRS are also making certain regulatory changes to reflect statutory changes that occurred as part of the Taxpayer Relief Act of 1997 (Public Law 105–34). Effective June 8, 1997, Congress lengthened the period of time from five years to seven for accounting for section 704(c) gain or loss

with respect to distributions. Consistent with the statutory changes, various provisions in §1.704–4 and §1.737–1 have been amended.

Effective Dates

Except as otherwise provided, these proposed regulations will be effective for any distributions of property after January 19, 2005, if such property was contributed in an assets-over merger after May 3, 2004. Provisions relating to the change in the regulations in §1.704–4 and §1.737–1 from the previous five-year rule to the seven-year rule will be effective August 22, 2007.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and IRS request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for **December 5, 2007**, 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by November 20, 2007, and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by November 21, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Jason Smyczek and Laura Fields, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.704–3 also issued under 26 U.S.C. 704. * * *

Par. 2. Section 1.704–3 is amended as follows:

1. Paragraphs (a)(9) through (a)(12) are redesignated as paragraphs (a)(10) through (a)(13), respectively.

2. New paragraph (a)(9) is added.

3. Paragraph (f) is amended by revising the paragraph heading and adding one additional sentence at the end of the paragraph.

The revisions and additions read as follows:

§1.704–3 Contributed Property.

(a)* * *

(9) *Section 704(c) property transferred in an assets-over merger.* Assets transferred to a transferee partnership from the transferor partnership in an assets-over merger as defined in §1.708–1(c)(3) (the transferor partnership being the partnership considered to have been terminated under §1.708–1(c)(1) and the transferee partnership being the partnership considered to be the resulting partnership under §1.708–1(c)(1)) may have both original section 704(c) gain or loss (see §1.704–4(c)(4)(ii)(A) for the definition of original section 704(c) gain or loss) and new section 704(c) gain or loss. The transferee partnership may continue to use the section 704(c) allocation method adopted by the transferor partnership with respect to section 704(c) property originally contributed to the transferor partnership or it may adopt another reasonable section 704(c) method. Also, the transferee partnership may continue to use the section 704(c) allocation method adopted by the transferor partnership with respect to new section 704(c) gain or loss to account for differences between book value and adjusted tax basis as a result of a prior revaluation. In addition, the transferee partnership may adopt any reasonable section 704(c) method with respect to new section 704(c) gain or loss in excess of the amount of new section 704(c) gain or loss described in the prior sentence. With respect to both original and new section 704(c) gain or loss, the transferee partnership must use a reasonable method that is consistent with the purpose of sections 704(b) and 704(c).

* * *

(f)_ *Effective/applicability date.* * * * Paragraph (a)(9) is effective for any distribution of property after January 19, 2005, if such property was contributed in a merger using the assets-over form after May 3, 2004.

Par. 3. Section 1.704–4 is amended as follows:

1. Paragraph (a)(1) is amended by removing the phrase "five years" and adding in its place the phrase "seven years."

2. Paragraph (a)(4)(i) is amended by removing the phrase "five-year" and adding in its place the phrase "seven-year."

3. Paragraph (a)(4)(ii) is amended by removing the phrase "five-year" and adding in its place the phrase "seven-year."

4. Paragraphs (c)(4)(i) and (c)(4)(ii) are added.

5. Paragraph (c)(7) is redesignated as paragraph (c)(8).

6. A new paragraph (c)(7) is added.

7. Paragraphs (f)(2), Examples (1) and (2) are amended by removing the language "five-year" and replacing it with the language "seven-year" wherever it appears throughout both examples.

8. Paragraph (g) is amended by revising the paragraph heading and adding two sentences at the end of the paragraph.

The revisions and additions read as follows:

§1.704–4 Distribution of contributed property.

* * * * *

(c) * * *

(4) *Complete transfer to another partnership (Assets-Over Merger).* (i) *In general.* Section 704(c)(1)(B) and this section do not apply to the transfer in an assets-over merger as defined in §1.708–1(c)(3) by a partnership (the transferor partnership, which is considered to be the terminated partnership as a result of the merger) of all of its assets and liabilities to another partnership (the transferee partnership, which is considered to be the resulting partnership after the merger), followed by a distribution of the interest in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement.

(ii) *Subsequent distributions.* Except as provided in paragraph (c)(4)(E) below, section 704(c)(1)(B) and this section apply to the subsequent distribution by the transferee partnership of section 704(c) property contributed by the transferor partnership to the transferee partnership in an assets-over merger, as provided in paragraphs (c)(4)(ii)(A) through (D) of this section.

(A) *Original section 704(c) gain or loss.* The seven-year period in section 704(c)(1)(B) does not restart with respect to original section 704(c) gain or loss as a result of the transfer of the section 704(c) property to the transferee partnership. For purposes of this paragraph (c)(4)(ii)(A), the amount of original section 704(c) gain or loss is the difference between the property's fair market value and the contributing partner's adjusted tax basis, at the time of contribution, to the extent such difference has not been eliminated by section 704(c) allocations, prior revaluations, or in connection with the merger. See §§1.704–4(a) and (b) for post-merger distributions of property contributed to the transferee partnership prior to the merger. A subsequent distribution by the transferee partnership of property with original section 704(c) gain or loss to a partner other than the partner that contributed such property to the transferor partnership is subject to section 704(c)(1)(B) if the distribution occurs within seven years of the contribution of the property to the transferor partnership. See §1.704–4(c)(4)(ii)(B) for rules relating to the distribution of property with new section 704(c) gain or loss. See §1.737–2(b)(1)(ii)(A) for a similar rule in the context of section 737.

(B) *New section 704(c) gain or loss.* A subsequent distribution of property with new section 704(c) gain or loss by the transferee partnership to a partner other than the contributing partner is subject to section 704(c)(1)(B) if the distribution occurs within seven years of the contribution of the property to the transferee partnership by the transferor partnership. For these purposes, a partner of the transferor partnership is deemed to have contributed to the transferee partnership an undivided interest in the property of the transferor partnership. The determination of the partners' undivided interest for this purpose shall be determined by the transferor partnership using any reasonable method. New section 704(c) gain or loss shall be allocated among the partners of the transferor partnership in a manner consistent with the principles of §§1.704–3(a)(7) and 1.704–3(a)(10). See §1.737–2(d)(4) for a similar rule in the context of section 737.

(C) *Ordering Rule.* (1) *Post-merger revaluation.* Revaluations after a merger that reflect a reduction in the amount of built-in gain or loss inherent in property will reduce new section 704(c) gain or loss prior to reducing original section 704(c) gain or loss.

(2) *Post-merger partial recognition.* For purposes of this section, if less than all of a section 704(c) property is distributed, then a proportionate amount of original and new section 704(c) gain or loss must be recognized.

(D) *Subsequent Mergers.* If the transferee partnership (first transferee partnership) is subsequently merged into another partnership (new transferee partnership) the new section 704(c) gain or loss that resulted from the merger of the transferor partnership into the first transferee partnership shall be subject to section 704(c)(1)(B) for seven years from the time of the contribution by the transferor partnership to the first transferee partnership (original merger) and new section 704(c) gain or loss that resulted from the merger of the first transferee into the new transferee (subsequent merger) shall be subject to section 704(c)(1)(B) for seven years from the time of the subsequent merger. See §1.737–2(b)(1)(ii)(D) for a similar rule in the context of section 737.

(E) *Identical Ownership or De Minimis Change in Ownership Exception.* Section 704(c)(1)(B) and this section do not apply to new section 704(c) gain or loss in property transferred by the transferor partnership to the transferee partnership if both the transferor partnership and the transferee partnership are owned by the same owners in the same proportions or the difference in ownership is *de minimis.* The transferor partnership and the transferee partnership are owned by the same owners in the same proportions if each partner owns identical interests in book capital and in each item of income, gain, loss, deduction, and credit, and identical shares of distributions and liabilities in each of the transferor and transferee partnerships. A difference in ownership is *de minimis* if ninety seven percent of the interests in book capital and in each item of income, gain, loss, deduction and credit and shares of distributions, and liabilities of the transferor partnership and transferee partnership are owned by the same owners in the same proportions.

(F) *Examples.* The following examples illustrate the rules of paragraph (c)(4)(ii) of this section.

Example (1). New section 704(c) gain. (i) *Facts.* On January 1, 2005, A contributes Asset 1, with a

basis of $200x and a fair market value of $300x, to partnership PRS1 in exchange for a 50 percent interest. On the same date, B contributes $300x of cash to PRS1 in exchange for a 50 percent interest. Also on January 1, 2005, C contributes Asset 2, with a basis of $100x and a fair market value of $200x, to partnership PRS2 in exchange for a 50 percent interest. D contributes $200x of cash to PRS2 in exchange for a 50 percent interest. On January 1, 2008, PRS1 and PRS2 undertake an assets-over partnership merger in which PRS1 is the continuing partnership and PRS2 is the terminating partnership for both state law and federal tax purposes. At the time of the merger, PRS1's only assets are Asset 1, with a fair market value of $900x, and $300x in cash. PRS2's only assets are Asset 2, with a fair market value of $600x, and $200x in cash. After the merger, the partners have book capital and profits interests in PRS1 as follows: A, 30 percent; B, 30 percent; C, 20 percent; and D, 20 percent. PRS1 and PRS2 both have provisions in their respective partnership agreements requiring the revaluation of partnership property upon entry of a new partner. PRS1 would not be treated as an investment company (within the meaning of section 351) if it were incorporated. Neither partnership holds any unrealized receivables or inventory for purposes of section 751. In addition, neither partnership has a section 754 election in place. Asset 1 and Asset 2 are nondepreciable capital assets. On January 1, 2013, PRS1 has the same assets that it had after the merger. Each asset has the same value that it had at the time of the merger. On this date, PRS1 distributes Asset 2 to A in liquidation of A's interest.

(ii) *Analysis.* On the date of the merger of PRS2 into PRS1, the fair market value of Asset 2 ($600x) exceeded its adjusted tax basis ($100x). Thus, pursuant to §1.704–4(c)(4)(ii)(A), when Asset 2 was contributed to PRS1 in the merger, it was section 704(c) gain property. The total amount of the section 704(c) gain was $500x ($600x (fair market value) - $100x (adjusted basis)). The amount of original section 704(c) gain attributable to Asset 2 equals $100x, the difference between its fair market value ($200x) and adjusted tax basis ($100x) upon contribution to PRS2 by C. The amount of new section 704(c) gain attributable to Asset 2 equals $400x, the total amount of section 704(c) gain ($500x) less the amount of the original section 704(c) gain ($100x). The distribution of Asset 2 to A occurs more than seven years after the contribution by C of Asset 2 to PRS2. Therefore, pursuant to §1.704–4(c)(4)(ii)(A), section 704(c)(1)(B) does not apply to the $100x of original section 704(c) gain. The distribution of Asset 2 to A, however, occurs within seven years of the contribution in the merger of Asset 2 to PRS1 by PRS2. Pursuant to §1.704–4(c)(4)(ii)(B), section 704(c)(1)(B) applies to the new section 704(c) gain. As the transferees of PRS2's partnership interest in PRS1, C and D succeed to one-half of the $400x of the new section 704(c) gain created by the merger. Thus, as a result of the distribution of Asset 2 to A within seven years of the merger, C and D are required to recognize $200x of gain each. See §1.737–2(b)(1)(ii)(F), *Example (1)* for analysis of a similar example under section 737.

Example (2). Revaluation gain and merger gain. (i) *Facts.* The facts are the same as *Example (1)*, except that during 2005, PRS2 admitted E as a new partner in PRS2 at a time when the fair market value of Asset 2 was $300x and PRS2's only other asset was cash of $200x. In exchange for a contribution of cash of $250x, E was admitted as a one-third partner in PRS2. In accordance with the terms of PRS2's partnership agreement, the partnership revalued its assets pursuant to §1.704–1(b)(2)(iv)(f) upon admission of E so that the unrealized gain of $100x attributable to Asset 2 was allocated equally between C and D, or $50x each. On January 1, 2008, PRS2 merges into PRS1. At the time of the merger, PRS1's only assets are Asset 1, with a fair market value of $550x, and $300x in cash. PRS2's only assets are Asset 2, with a fair market value of $400x, and $450x in cash. After the merger, the partners have book capital and profits and loss interests in PRS1 as follows: A, 25%; B, 25%; C, 16.67%; D, 16.67% and E, 16.67%. On January 1, 2011, Asset 2 is distributed to A when its value is still $400x.

(ii) Analysis. On the date of the merger of PRS2 into PRS1, the fair market value of Asset 2 ($400x) exceeded its adjusted tax basis ($100x). Thus, when Asset 2 was contributed to PRS1 in the merger, it was section 704(c) gain property. The total amount of the section 704(c) gain was $300x ($400x (fair market value) - $100x (adjusted basis)). The amount of the original section 704(c) gain attributable to Asset 2 equals $100x, the difference between its fair market value of $200x and adjusted tax basis $100x upon contribution to PRS2 by C. The amount of the new section 704(c) gain attributable to Asset 2 equals $200x, the total section 704(c) gain ($300x) less the amount of the original section 704(c) gain ($100x). The distribution of Asset 2 to A occurs within seven years after the contribution by C to PRS2. Therefore, pursuant to §1.704–4(c)(4)(ii)(A), section 704(c)(1)(B) applies to the original section 704(c) gain. The distribution of Asset 2 to A also occurs within seven years of the contribution of Asset 2 to PRS1 by PRS2. Pursuant to §1.704–4(c)(4)(ii)(B), section 704(c)(1)(B) applies to the new section 704(c) gain. As the transferees of PRS2's partnership interest in PRS1, C and D each succeed to $50x of new section 704(c) gain as a result of the revaluation of Asset 2 upon admission of E as a partner. Moreover, C, D and E each succeed to $33.33x of new section 704(c) gain as a result of the merger. C also has $100 of original section 704(c) gain as a result of the original contribution of Asset 2 to PRS2. Thus, as a result of the distribution of Asset 2 to A within seven years of the merger, C, D and E are each required to recognize gain. C will recognize a total of $183.33x of gain ($100x of original section 704(c) gain and $83.33x of new section 704(c) gain). D will recognize a total of $83.33x of gain (all new section 704(c) gain) and E will recognize $33.33x of gain (all new section 704(c) gain). See §1.737–2(b)(1)(ii)(F), *Example (2)* for a similar example under section 737.

Example (3). Revaluation loss and merger gain. (i) *Facts.* The facts are the same as *Example (1)* except that during 2005, PRS2 admitted E as a new partner in PRS2 at a time when the fair market value of Asset 2 was $150x and PRS2's only other asset was cash of $200x. In exchange for a contribution of cash of $175x, E was admitted as a one-third partner in PRS2. In accordance with the terms of PRS2's partnership agreement, the partnership revalued its assets upon admission of E so that the unrealized loss of $50x attributable to Asset 2 was allocated equally between C and D, or $25x each. On January 1, 2008, PRS 2 merges into PRS1. At the time of the merger, PRS1's only assets are Asset 1, with a fair market value of $900x, and $300x in cash. PRS2's only assets are Asset 2, with a fair market value of $600x, and $375x in cash. After the merger, the partners have book capital and profits and loss interests in PRS1 as follows: A, 27.5%; B, 27.5%; C, 15%; D, 15% and E, 15%. On January 1, 2013, Asset 2 is distributed to A when its value is still $600.

(ii) *Analysis.* On the date of the merger of PRS2 into PRS1, the fair market value of Asset 2 ($600x) exceeded its adjusted tax basis ($100x). Thus, when Asset 2 was contributed to PRS1 in the merger, it was section 704(c) gain property. The total amount of the section 704(c) gain was $500x ($600x (fair market value) - 100x (adjusted basis)). The amount of the original section 704(c) gain attributable to Asset 2 equals $50x, the difference between its fair market value ($200x) and adjusted tax basis ($100x) upon contribution to PRS2 by C, less the unrealized loss ($50X) attributable to the revaluation of PRS2 on the admission of E as a partner in PRS2. The amount of the new section 704(c) gain attributable to Asset 2 equals $450x, the total section 704(c) gain ($500x) less the amount of the original section 704(c) gain ($50x). The distribution of Asset 2 to A occurs more than seven years after the contribution by C to PRS2. Therefore, pursuant to §1.704–4(c)(4)(ii)(A), section 704(c)(1)(B) does not apply to the original section 704(c) gain. The distribution of Asset 2 to A, however, occurs within seven years of the contribution of Asset 2 to PRS1 and PRS2. Pursuant to §1.704–4(c)(4)(ii)(B), section 704(c)(1)(B) applies to the new section 704(c) gain. As the transferees of PRS2's partnership interest in PRS1, C, D and E each succeed to $150 of new section 704(c) gain. Thus, as a result of the distribution of Asset 2 to A within seven years of the merger, C, D and E are each required to recognize $150 of gain.

Example (4). Reverse section 704(c) gain. (i) *Facts.* The facts are the same as *Example (1)*, except that on January 1, 2013, PRS1 distributes Asset 1 to C in liquidation of C's interest in PRS1.

(ii) *Analysis.* The distribution of Asset 1 to C occurs more than seven years after the contribution of Asset 1 to PRS1. Thus, pursuant to §1.704–4(c)(4)(ii)(A), section 704(c)(1)(B) does not apply to the original section 704(c) gain. Pursuant to §1.704–4(c)(7), section 704(c)(1)(B) does not apply to reverse section 704(c) gain in Asset 1 resulting from a revaluation of PRS1's partnership property at the time of the merger. Accordingly, neither A nor B will recognize gain under section 704(c)(1)(B) as a result of the distribution of Asset 1 to C. See §1.737–2(b)(1)(ii)(F), *Example (4)* for a similar example under section 737.

Example (5). Identical ownership exception. (i) *Facts.* In 1990, A, an individual, and B, a subchapter C corporation, formed PRS1, a partnership. A owned 75 percent of the interests in the book capital (as determined for purposes of §1.704–1(b)(2)(iv)), profits, losses, distributions, and liabilities (under section 752) of PRS1. B owned the remaining 25 percent interest in the book capital, profits, losses, distributions, and liabilities of PRS1. In the same year, A and B also formed another partnership, PRS2, with A owning 75 percent of the interests in the book capital, profits, losses, distributions, and liabilities of PRS2 and B owning the remaining 25 percent of the book capi-

tal, profits, losses, distributions, and liabilities. Upon formation of the partnerships, A contributed the Asset X to PRS1 and Asset Y to PRS2 and B contributed cash. Both Assets X and Y had section 704(c) built-in gain at the time of contribution to the partnerships.

(ii) In January 2005, PRS1 is merged into PRS2 in an assets-over merger in which PRS1 is the terminating partnership and PRS2 as the continuing partnership for both state law and federal income tax purposes. At the time of the merger, both Asset X and Y had increased in value from the time they were contributed to PRS1 and PRS2, respectively. As a result, a new layer of section 704(c) gain was created with respect to Asset X in PRS1, and reverse section 704(c) gain was created with respect to Asset Y in PRS2. After the merger, A had a 75 percent interest in PRS2's capital, profits, losses, distributions, liabilities, and all other items. B held the remaining 25 percent interest in PRS2's capital, profits, losses, distributions, liabilities, and all other items. In 2006, PRS2 distributes all of Asset X to A.

(iii) *Analysis.* The 2006 distribution of Asset X occurs more than seven years after the formation of the partnerships and the original contribution of both Assets X and Y to the partnerships. Therefore, the original layer of built-in gain created on the original contribution of Asset X to PRS1 is not taken into account in applying section 704(c)(1)(B) to the proposed distribution. In addition, paragraph (c)(4)(ii)(E) of this section provides that section 704(c)(1)(B) and paragraph (c)(4)(ii)(B) of this section do not apply to new section 704(c) gain or loss in property transferred by the transferor partnership to the transferee partnership if both the transferor partnership and the transferee partnership are owned by the same owners in the same proportions. The transferor partnership and the transferee partnership are owned by the same owners in the same proportions if each partner's percentage interest in the transferor partnership's book capital, profits, losses, distributions, and liabilities, is the same as the partner's percentage interest in those items of the transferee partnership. In this case, A owned 75 percent and B owned 25 percent of the interests in the book capital, and in each item of income, gain, loss and credit, and share of distributions and liabilities of PRS1 and PRS2 prior to the merger and 75 percent and 25 percent, respectively, of PRS2 after the merger. As a result, the requirements of the identical ownership exception of paragraph (c)(4)(ii)(E) of this section are satisfied. Thus, the new built-in gain created upon contribution of Asset X in connection with the partnership merger will not be taken into account in applying section 704(c)(1)(B) to the proposed distribution. See §1.737–2(b)(1)(ii)(F), *Example (5)* for a similar example under section 737.

* * *

(7) *Reverse section 704(c) gain or loss.* Section 704(c)(1)(B) and this section do not apply to reverse section 704(c) gain or loss as described in §1.704–3(a)(6)(i).

* * * * *

(g) *Effective/applicability date.* * * * Paragraphs (a)(1), (a)(4)(i), (a)(4)(ii), and (f)(2), *Examples (1) and (2),* are effective August 20, 2007. Paragraphs (c)(4) and (c)(7) are effective for any distributions of property after January 19, 2005, if such property was contributed in a merger using the assets-over form after May 3, 2004.

Par. 4. Section 1.737–1(c)(1) is amended by removing the phrase "five years" and adding in its place the phrase "seven years."

Par. 5. Section 1.737–2 is amended as follows:

1. Paragraph (b) is revised.

2. Paragraph (e) is redesignated as paragraph (f).

3. New paragraph (e) is added.

The additions and revisions read as follows:

§1.737–2 Exceptions and special rules.

* * * * *

(b) *Transfers to another partnership.* (1) *Complete transfer to another partnership (Assets-over merger).* (i) *In General.* Section 737 and this section do not apply to a transfer in an assets-over merger as defined in §1.708–1(c)(3) by a partnership (the transferor partnership, which is considered to be the terminated partnership as a result of the merger) of all of its assets and liabilities to another partnership (the transferee partnership, which is considered to be the resulting partnership after the merger) followed by a distribution of the interest in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement.

(ii) *Subsequent distributions.* (A) *Original section 704(c) gain.* If, immediately before the assets-over merger, the transferor partnership holds property that has original built-in gain (as defined in §1.704–4(c)(4)(ii)(A)), the seven year period in section 737(b) does not restart with respect to such gain as a result of the transfer of such section 704(c) property to the transferee partnership. A subsequent distribution of other property by the transferee partnership to the partner who contributed the original section 704(c) gain property to the transferor partnership is only subject to section 737 with respect to the original section 704(c) gain if the distribution occurs within seven years of the time such property was contributed to the transferor partnership. See §1.704–4(c)(4)(ii)(A) for a similar provision in the context of section 704. See §1.737–1 for post-merger distribution of property contributed to the transferee partnership prior to the merger.

(B) *New section 704(c) gain.* Except as provided in paragraph (b)(1)(ii)(E) of this section, if new built-in gain is created upon the contribution of assets by the transferor partnership to the transferee partnership, a subsequent distribution by the transferee partnership of property to a partner of the transferee partnership (other than property deemed contributed by such partner) is subject to section 737, if such distribution occurs within seven years of the contribution by the transferor partnership to the transferee partnership. For these purposes, a partner of the transferor partnership is deemed to have contributed to the transferee partnership an undivided interest in the property of the transferor partnership. The determination of the partner's undivided interest for this purpose shall be determined by the transferor partnership using any reasonable method. See §1.704–4(c)(4)(ii)(B) for a similar provision in the context of section 704.

(C) *Ordering Rule.* For purposes of this section, if a partner is required to recognize gain under this section, the partner shall recognize a proportionate amount of original and new section 704(c) gain.

(D) *Subsequent Mergers.* If the transferee partnership (first transferee partnership) is subsequently merged into another partnership (new transferee partnership) the section 704(c) gain that resulted from the merger of the transferor partnership into the first transferee partnership shall be subject to section 737 for seven years from the time of the contribution by the transferor partnership to the first transferee partnership (original merger) and section 704(c) gain that resulted from the merger of the first transferee partnership into the new transferee partnership shall be subject to section 737 for seven years from the time of the contribution by the first transferee partnership to the new transferee partnership (subsequent merger). See §1.704–4(c)(4)(ii)(D) for a similar rule in the context of section 704.

(E) *Identical Ownership or De Minimis Change In Ownership.* For purposes of section 737(b) and this section, net precontribution gain does not include new section 704(c) gain in property transferred by the transferor partnership to the transferee partnership if both the transferor partnership and the transferee partnership

are owned by the same owners in the same proportions or if the difference in ownership is *de minimis*. The transferor partnership and the transferee partnership are owned by the same owners in the same proportions if each partner owns identical interests in book capital and each item of income, gain, loss, deduction, and credit, and identical shares of distributions and liabilities in each of the transferor and transferee partnerships. A difference in ownership is *de minimis* if ninety seven percent of interests in book capital and each item of income, gain, loss, deduction and credit and shares in distributions and liabilities of the transferor partnership and transferee partnership are owned by the same owners in the same proportions. See §1.704–4(c)(4)(ii)(E) for a similar provision in the context of section 704.

(F) *Examples.* The following examples illustrate the rules of paragraph (b)(3) of this section.

Example (1). No net precontribution gain. (i) *Facts.* On January 1, 2005, A contributes Asset 1, with a basis of $200x and a fair market value of $300x, to partnership PRS1 in exchange for a 50 percent interest. On the same date, B contributes $300x of cash to PRS1 in exchange for a 50 percent interest. Also on January 1, 2005, C contributes Asset 2, with a basis of $100x and a fair market value of $200x, to partnership PRS2 in exchange for a 50 percent interest. D contributes $200x of cash to PRS2 in exchange for a 50 percent interest. On January 1, 2008, PRS1 and PRS2 undertake an assets-over partnership merger in which PRS1 is the continuing partnership and PRS2 is the terminating partnership for both state law and federal tax purposes. At the time of the merger, PRS1's only assets are Asset 1, with a fair market value of $900x, and $300x in cash. PRS2's only assets are Asset 2, with a fair market value of $600x and $200x in cash. After the merger, the partners have capital and profits interests in PRS1 as follows: A, 30 percent; B, 30 percent; C, 20 percent; and D, 20 percent. PRS1 and PRS2 both have provisions in their respective partnership agreements requiring the revaluation of partnership property upon entry of a new partner. PRS1 would not be treated as an investment company (within the meaning of section 351) if it were incorporated. Neither partnership holds any unrealized receivables or inventory for purposes of section 751. In addition, neither partnership has a section 754 election in place. Asset 1 and Asset 2 are nondepreciable capital assets. On January 1, 2013, PRS1 has the same assets that it had after the merger. Each asset has the same value that it had at the time of the merger. On this date, PRS1 distributes Asset 2 to A in liquidation of A's interest.

(ii) *Analysis.* Section 737(a) requires A to recognize gain when it receives a distribution of property in an amount equal to the lesser of the excess distribution or the partner's net precontribution gain. The distribution of Asset 2 to A results in an excess distribution of $400x ($600x fair market value of Asset 2 - $200x adjusted basis in A's partnership interest). However, the distribution of Asset 2 to A occurs more than seven years after the contribution by A of Asset 1 to PRS1 and A made no subsequent contributions to PRS1. Therefore, A's net precontribution gain for purposes of section 737(b) at the time of the distribution is zero. The $600x of reverse section 704(c) gain in Asset 1, resulting from a revaluation of PRS1's partnership property at the time of the merger, is not net precontribution gain (See §1.737–2(e)). Accordingly, A will not recognize gain under section 737 as a result of the distribution of Asset 2. See §1.704–4(c)(4)(ii)(F), *Example (1)* for a similar example under section 704.

Example (2). Revaluation gain and merger gain. (i) *Facts.* The facts are the same as *Example (1)*, except that on January 1, 2007, E joins PRS2 as a one-third partner for $250x in cash. At the time E joins the partnership, Asset 2 has a fair market value of $300x. On January 1, 2008, PRS2 merges into PRS1. At the time of the merger, Asset 1 and Asset 2 both have a fair market value of $400x. On January 1, 2011, Asset 1 is distributed to C when its value is $275x.

(ii) *Analysis.* Section 737(a) requires A to recognize gain when it receives a distribution of property in an amount equal to the lesser of the excess distribution or the partner's net precontribution gain. The distribution of Asset 1 to C results in an excess distribution of $175x ($275x fair market value of Asset 1 - $100x adjusted basis in C's partnership interest). The distribution of Asset 1 to C occurs within seven years of the original contribution of Asset 2 by C to PRS2. Therefore, C's net precontribution gain at the time of the distribution is $183.33x, which includes C's original section 704(c) gain from the contribution of Asset 2 to PRS2 of $100x plus C's share of new section 704(c) gain of $83.33x ($50x of reverse section 704(c) gain upon the admission of E, plus $33.33x of additional section 704(c) gain upon merger). C's excess distribution is less than C's net precontribution gain. Thus, C will recognize $175x of gain upon receipt of Asset 1 in accordance with section 737(a). See §1.704–4(c)(4)(ii)(F), *Example (2)* for a similar example under section 704.

Example (3). Fluctuations in the value of an asset. (i) *Facts.* The facts are the same as *Example (1)*, except that on January 1, 2011, Asset 1 is distributed to C when its fair market value is $300x. Immediately prior to the distribution, PRS1 revalues its property in accordance with §1.704–1(b)(2)(iv)(f).

(ii) *Analysis.* The distribution of Asset 1 to C occurs within seven years of the original contribution of Asset 2 by C to PRS2 and within seven years of the date of the merger. Therefore, C's net precontribution gain at the time of the distribution equals $300x ($100x of original section 704(c) gain from the contribution of Asset 2 to PRS2 and $200x of new section 704(c) gain). The distribution of Asset 1 to C results in an excess distribution of $200x ($300x fair market value of Asset 1 - $100x adjusted basis in C's partnership interest). Accordingly, in accordance with section 737(a), C will recognize gain of $200x upon receipt of Asset 1.

Example (4). Reverse section 704(c) gain. (i) *Facts.* The facts are the same as *Example (1)*, except that on January 1, 2011, PRS1 distributes Asset 2 to A in liquidation of A's interest in PRS1. At the time of the distribution, Asset 2 has a value of $600x.

(ii) *Analysis.* Section 737(a) requires A to recognize gain when it receives a distribution of property in an amount equal to the lesser of the excess distribution or the partner's net precontribution gain. The distribution of Asset 2 to A results in an excess distribution of $400x ($600x fair market value - 200x adjusted basis in A's partnership interest). The distribution of Asset 2 to A occurs within seven years after the contribution of Asset 1 to PRS1 by A. Thus, A's net precontribution gain for purposes of section 737(b) at the time of the distribution is $100x (A's original section 704(c) gain from the contribution of Asset 1 to PRS1). Under §1.737–2(e), A's net precontribution gain does not include A's reverse section 704(c) gain upon the revaluation of the Assets of PRS1 prior to the merger. Accordingly, A will recognize $100x of gain (the lesser of the excess distribution or net precontribution gain) under section 737 as a result of the distribution of Asset 2. See §1.704–4(c)(4)(ii)(F), *Example (4)* for a similar example under section 704.

Example (5). Identical ownership exception. (i) *Facts.* In 1990, A, an individual, and B, a subchapter C corporation, formed PRS1, a partnership. A owned 75 percent of the interests in the book capital, profits, losses, distributions, and liabilities of PRS1. B owned the remaining 25 percent interest in the book capital, profits, losses, distributions, and liabilities of PRS1. In the same year, A and B also formed another partnership, PRS2, with A owning 75 percent of the interests in PRS2 and B owning the remaining 25 percent. Upon formation of the partnerships, A contributed Asset X to PRS1 and Asset Y to PRS2 and B contributed cash. Both Assets X and Y had section 704(c) built-in gain at the time of contribution to the partnerships.

(ii) In January 2005, PRS1 is merged into PRS2 in an assets-over merger in which PRS1 is the terminating partnership and PRS2 as the continuing partnership for both state law and federal income tax purposes. At the time of the merger, both Assets X and Y had increased in value from the time they were contributed to PRS1 and PRS2, respectively. As a result, a new layer of section 704(c) gain was created with respect to Asset X in PRS1. After the merger, A had a 75 percent interest in PRS2's book capital, profits, losses, distributions, and liabilities. B held the remaining 25 percent interest in PRS2's book capital, profits, losses, distributions, and liabilities. In 2006, PRS2 distributes all of Asset X to A.

(iii) *Analysis.* The 2006 distribution by PRS2 occurs more than seven years after the formation of the partnerships and the original contribution of Asset X to the partnerships. Therefore, the original layer of built-in gain created on the original contribution of Asset X to the partnerships should not be taken into account in applying section 737 to the proposed liquidation. In addition, paragraph (b)(1)(ii)(E) of this section provides that section 737(a) does not apply to newly created section 704(c) gain in property transferred by the transferor partnership to the transferee partnership if both the transferor partnership and the transferee partnership are owned by the same owners in the same proportions. The transferor partnership and the transferee partnership are owned by the same owners in the same proportions if each partner's percentage interest in the transferor partnership's book capital, profits, losses, distributions, and liabilities is the same as the partner's percentage interest in those items of the transferee partnership. In this case, A

owned 75 percent and B owned 25 percent of the interests in the book capital, profits, losses, distributions, and liabilities of PRS1 and PRS2 prior to the merger and 75 percent and 25 percent, respectively, of PRS2 after the merger. As a result, the requirements of the identical ownership exception of paragraph (b)(1)(ii)(E) of this section are satisfied. Thus, the new built-in gain created upon contribution of Asset X in connection with the partnership merger will not be taken into account in applying section 737 to the proposed distribution. See §1.704–4(c)(4)(ii)(F), *Example (5)* for a similar example under section 704.

(2) *Certain divisive transactions*. (i) *In general*. Section 737 and this section do not apply to a transfer by a partnership (transferor partnership) of all of the section 704(c) property contributed by a partner to a second partnership (transferee partnership) in an exchange described in section 721, followed by a distribution as part of the same plan or arrangement of an interest in the transferee partnership (and no other property) in complete liquidation of the interest of the partner that originally contributed the section 704(c) property to the transferor partnership (divisive transactions).

(ii) *Subsequent distributions*. After a divisive transaction referred to in paragraph (b)(2)(i) of this section, a subsequent distribution of property by the transferee partnership to a partner of the transferee partnership that was formerly a partner of the transferor partnership is subject to section 737 to the same extent that a distribution from the transferor partnership would have been subject to section 737.

* * * * *

(f) *Reverse section 704(c) gain*. For purposes of section 737(b), net precontribution gain does not include reverse section 704(c) gain as described in §1.704–3(a)(6)(i).

Par. 6. Section 1.737–5 is amended by revising the section heading and adding two additional sentences at the end of the paragraph to read as follows:

§1.737–5 *Effective applicability date*. * * * Section 1.737–1(c) is effective as of August 22, 2007. Section 1.737–2(b)(1) is effective for any distribution of property after January 19, 2005, if such property was contributed in a merger using the assets-over form after May 3, 2004.

Kevin M. Brown,
Deputy Commissioner for Service and Enforcement.

(Filed by the Office of the Federal Register on August 21, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 22, 2007, 72 F.R. 46932)

Exclusions From Gross Income of Foreign Corporations; Correction

Announcement 2007–84

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final and temporary regulations.

SUMMARY: This document contains corrections to final and temporary regulations (T.D. 9332, 2007–32 I.R.B. 300) that were published in the **Federal Register** on Monday, June 25, 2007 (72 FR 34600) relating to the exclusion from gross income of income derived by certain foreign corporations engaged in the international operation of ships or aircraft.

DATES: The correction is effective August 13, 2007.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray, (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final and temporary regulations that are the subject of this correction are under section 883 of the Internal Revenue Code.

Need for Correction

As published, final and temporary regulations (T.D. 9332) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final and temporary regulations (T.D. 9332), which were the subject of FR Doc. E7–12039, is corrected as follows:

1. On page 34601, column 3, in the preamble, under the paragraph heading "*2. Elimination of Foreign Base Company Shipping Income*", line 3, the language "(118 Stat. 1418) (AJCA) repealed section" is corrected to read "(118 Stat. 1418)) (AJCA) repealed section".

2. On page 34602, column 3, in the preamble, under the paragraph heading "*C. Reporting requirements related to qualified shareholder stock ownership test*", last line, the language "at the office of that such practitioner." is corrected to read "at the office of that practitioner.".

3. On page 34603, column 1, in the preamble, under the paragraph heading "*2. Activities Incidental to the International Operation of Ships or Aircraft*", line 7 from the bottom of the paragraph, the language "to the international operation of a ship" is corrected to read "to the international operation of ships".

4. On page 34603, column 3, in the preamble, under the paragraph heading "*4. Countries that Provide an Exemption Through an Income Tax Convention and by Other Means*", lines 5 through 10, the language "exemption under section 883 through a diplomatic note, domestic statutory law, or by generally imposing no income tax on foreign corporations engaged in the international operation of ships or aircraft will continue to have the choice" is corrected to read "exemption under section 883 (through a diplomatic note, domestic statutory law, or because income tax is generally not imposed on foreign corporations engaged in the international operation of ships or aircraft) will continue to have the choice".

5. On page 34604, column 1, in the preamble, under the paragraph heading "*5. Reporting Requirements Related to Qualified Shareholder Stock Ownership Test*", first paragraph of the column, line 9, the language "addresses of shareholders in" is corrected to read "addresses of shareholders of".

6. On page 34604, column 2, in the preamble, under the paragraph heading "Effective Dates", line 1, the language "See § 1.883–5T(d) for effective date of" is corrected to read "See § 1.883–5T(d) for the effective date of".

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on August 10, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 13, 2007, 72 F.R. 45159)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–89

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 9, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Vietnam Chinese Mutual Aid & Friendship Association
San Francisco, CA

Fairdale Athletic Club, Inc.
Louisville, KY

Good Schools For All
San Francisco, CA

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 62.—Adjusted Gross Income Defined

A revenue procedure provides optional rules for deeming substantiated the amount of certain business expenses of traveling away from home reimbursed to an employee or deductible by an employee or self-employed individual. See Rev. Proc. 2007-63, page 809.

Section 162.—Trade or Business Expenses

A revenue procedure provides optional rules for deeming substantiated the amount of certain business expenses of traveling away from home reimbursed to an employee or deductible by an employee or self-employed individual. See Rev. Proc. 2007-63, page 809.

Section 267.—Losses, Expenses, and Interest With Respect to Transactions Between Related Taxpayers

A revenue procedure provides optional rules for deeming substantiated the amount of certain business expenses of traveling away from home reimbursed to an employee or deductible by an employee or self-employed individual. See Rev. Proc. 2007-63, page 809.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

A revenue procedure provides optional rules for deeming substantiated the amount of certain business expenses of traveling away from home reimbursed to an employee or deductible by an employee or self-employed individual. See Rev. Proc. 2007-63, page 809.

Section 430.—Minimum Funding Standards for Single-Employer Defined Benefit Pension Plans

26 CFR 1.430(f)–1: Effect of prefunding balance and funding standard carryover balance.

The proposed regulations under section 430(f) provide guidance regarding the use of certain funding balances maintained for defined benefit pension plans. The proposed regulations reflect changes made by the Pension Protection Act of 2006. See REG-113891-07, page 821.

Section 436.—Funding-Based Limits on Benefits and Benefit Accruals Under Single-Employer Plans

26 CFR 1.436–1: Limits on benefits and benefit accruals under single employer defined benefit plans.

The proposed regulations under section 436 provide guidance regarding benefit restrictions that apply to certain underfunded defined benefit pension plans. The proposed regulations reflect changes made by the Pension Protection Act of 2006. See REG-113891-07, page 821.

Section 442.—Change of Annual Accounting Period

This revenue procedure modifies a scope provision and one of the terms and conditions under which the Service grants approval of requests by corporations for changes in annual accounting periods filed under Rev. Proc. 2006–45, 2006–45 I.R.B. 851. See Rev. Proc. 2007-64, page 818.

Section 807.—Rules for Certain Reserves

(Also § 812.)

This ruling suspends Rev. Rul. 2007–54, 2007–38 I.R.B. 604, and informs taxpayers that Treasury and the Service intend to address the issues considered in Rev. Rul. 2007–54 by regulations. Rev. Rul. 2007–54 suspended.

Rev. Rul. 2007–61

Rev. Rul. 2007–54, 2007–38 I.R.B. 604, released on August 16, 2007, addresses the determination of life insurance reserves under section 807 of the Internal Revenue Code for a variable contract where some or all of the reserves are accounted for as part of a life insurance company's separate account reserves. The ruling also addresses the interest rate used under section 812(b)(2) to calculate required interest on the reserves if the amounts of those reserves are determined under section 807(d)(2).

Sections 807 and 812 were added to the Code by the Deficit Reduction Act of 1984, P.L. 98–369 (the 1984 Act). The legislative history of the 1984 Act provides that the regulations, rulings and case law under the Life Insurance Company Tax Act of 1959 (the 1959 Act) are to serve as interpretive guides to those 1984 Act provisions that carry over the provisions of prior law. *See* H. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess. 1402; S. Prt. 169, Vol. 1, 98th Cong. 2d Sess. 524. Since Rev. Rul. 2007–54 was issued, some taxpayers have argued that the provisions on which the ruling is based carried over from the 1959 Act to the 1984 Act, and that the ruling should not be applied retroactively because its analysis is not consistent with certain authorities under the 1959 Act.

The Treasury Department and the Internal Revenue Service (IRS) believe it is important that the company's share and policyholders' share of net investment income be determined in a manner that effectively prevents the double benefit that otherwise would result from the use of tax favored investment income (such as dividends qualifying for the dividends received deduction) to fund the company's obligations to policyholders. In addition, the Treasury Department and the IRS are mindful of the benefit of notice and public comment and believe the issues in the revenue ruling would more appropriately be addressed by regulation. Accordingly, this ruling suspends Rev. Rul. 2007–54 and informs taxpayers that the Treasury Department and the IRS intend to address in regulations the issues considered in Rev. Rul. 2007–54. Until such time, the issues should be analyzed as though Rev. Rul. 2007–54 had not been issued. Regulations also may provide guidance for determining required interest under section 812(b)(2) if neither the prevailing State assumed rate nor the applicable Federal rate is used to determine the reserves for an insurance or annuity contract. This project has been added to the 2007-2008 Priority Guidance Plan and will be reflected in the next periodic update to that plan.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2007–54 is suspended.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stephen D. Hooe of the Office of

Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact Mr. Hooe at (202) 622–3900 (not a toll-free call).

Section 812.—Definition of Company's Share and Policyholders' Share

A revenue ruling that suspends Rev. Rul. 2007–54, 2007–38 I.R.B. 604, and informs taxpayers that Treasury and the Service intend to address the issues considered in Rev. Rul. 2007–54 by regulations. See Rev. Rul. 2007-61, page 799.

Section 898.—Taxable Year of Certain Foreign Corporations

This revenue procedure modifies a scope provision and one of the terms and conditions under which the Service grants approval of requests by corporations for changes in annual accounting periods filed under Rev. Proc. 2006–45, 2006–45 I.R.B. 851. See Rev. Proc. 2007-64, page 818.

Section 6061.—Signing of Returns and Other Documents

This notice allows Electronic Return Originators (EROs) to sign the following forms by rubber stamp, mechanical device (such as signature pen), or computer software program: Form 8453, *U.S. Individual Income Tax Declaration for an IRS e-file Return*; Form 8878, *IRS e-file Signature Authorization for Form 4868 or Form 2350*; and Form 8879, *IRS e-file Signature Authorization*. See Notice 2007-79, page 809.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

United States Angola Reciprocol Exemption Agreement

Announcement 2007–88

The United States and Angola have exchanged diplomatic notes evidencing a reciprocal exemption agreement for income from the international operation of ships and aircraft for taxable years beginning on or after January 1, 2006. The diplomatic notes reproduced herein contain the terms of the reciprocal exemptions.

The principal author of this announcement is Patricia Bray of the Office of Associate Chief Counsel (International). For further information regarding this announcement, contact Patricia Bray at (202) 622–5871 (not a toll-free call).

The text of the agreement is as follows.

DRAFT 8/17/2005

PROPOSED
REVISED NOTE NO. 271

Note No. 271

The Embassy of the United States of America presents its compliments to the Ministry of External Relations of the Government of Angola and has the honor to propose that the two Governments conclude an agreement to exempt from income tax, on a reciprocal basis, certain income derived from the international operation of a ship or ships and aircraft as follows:

The Government of the United States of America in accordance with Section 872(b) and 883(a) of the U.S. Internal Revenue Code of 1986, as amended, agrees to exempt from U.S. federal income tax gross income derived from the international operation of a ship or ships or aircraft by individuals who are residents of Angola (other than U.S. citizens or residents) and corporations that are organized in Angola, in each case, that are engaged in the international operation of a ship or ships or aircraft. This exemption shall be granted on the basis of equivalent exemptions granted by the Government of Angola to individual residents of the United States and to corporations organized in the United States.

In the case of an Angolan corporation, the exemption shall apply only if the corporation meets either of the following conditions:

(1) More than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of the Republic of Angola or of another country which grants a reciprocal exemption to U.S. citizens and corporations; or

(2) The corporation's stock is primarily and regularly traded on an established securities market in the Republic of Angola, or is wholly owned, directly or indirectly, by a corporation whose stock is so traded and which is also organized in the Republic of Angola.

For purposes of Subparagraph (1), the Government of the Republic of Angola will be treated as an individual resident of the Republic of Angola. Subparagraph (1) will be considered to be satisfied if the corporation is a "controlled foreign corporation" under the Internal Revenue Code.

Gross income derived from the international operation of a ship or ships or aircraft includes:

(i) Income from the rental on a full (time or voyage) basis of a ship or ships or aircraft used in international transport;

(ii) Income from the rental on a bareboat basis of a ship or ships or aircraft used in international transport;

3145522.05

(iii) Income from the rental of containers and related equipment used in international transport that is incidental to income from the international operation of a ship or ships or aircraft;

(iv) Gains from the sale or other alienation of a ship or ships or aircraft used in international transport; and

(v) Income derived by an individual or corporation otherwise engaged in the international operation of a ship or ships or aircraft from active participation in a pool, an alliance, joint venture, international operating agency, or other venture, that is itself engaged in the international operation of a ship or ships or aircraft.

The Embassy, on behalf of the Government of the United States of America, proposes that if the foregoing is acceptable to the Government of Angola, this note and the Ministry's reply note shall constitute an agreement between the two Governments, which shall enter into force on the date of the Ministry's reply note and shall have effect with respect to taxable years beginning on or after January 1, 2005, and to all prior open taxable years. It shall remain in force until terminated by either Government giving written notice to the other Government through diplomatic channels.

The Embassy of the United States avails itself of this opportunity to renew to the Ministry of External Relations of the Government of Angola the assurance of its highest consideration.

The Embassy of the United States of America

- 2 - 3145522

REPÚBLICA DE ANGOLA
MINISTÉRIO DAS RELAÇÕES EXTERIORES

GABINETE DO VICE - MINISTRO

NOTA VERBAL N.º 116 /GVMRE/06

O Ministério das Relações Exteriores de Angola apresenta os seus melhores cumprimentos a Embaixada dos Estados Unidos da América e tem a honra de acusar a recepção da Nota de Resposta Revista de n.º 271/2005 da Embaixada dos Estados Unidos, propondo a troca de notas a isentar do imposto sobre o rendimento resultante da operação internacional de navio ou navios ou avião por empresas criadas nos Estados Unidos da América e que se dediquem à operação internacional de um navio ou navios ou avião. Esta isenção deve ser concedida com base na reciprocidade da isenção a conceder pelos Estados Unidos à empresas que sejam residentes em Angola (que não sejam cidadãos norte-americanos nem empresas e a empresas criadas em Angola).

O Governo angolano, de acordo com as disposições legais contidas no código de imposto industrial angolano (Imposto sobre rendimento) alínea g), n.º 1 do artigo 13º combinadas com a Lei n.º 18/92 de 3 de Julho nos termos do qual as empresas estrangeiras de navegação marítimas e aérea estão isentas do imposto industrial se, no País da sua nacionalidade, as empresas angolanas tiverem a mesma prerrogativa, concorda em isentar o imposto sobre o rendimento resultante da operação internacional de um navio ou navios ou avião por empresas que sejam residentes dos Estados Unidos da América e empresas criadas nos Estados Unidos, e que se dediquem à operação internacional de um navio ou navios ou avião.

O rendimento bruto resultante da operação internacional de um navio ou navios ou avião inclui:

(I) Rendimento do fretamento completo (tempo ou viagem) de um navio ou navios ou avião usados em transporte internacional;

(II) Rendimento do fretamento a casco nu de um navio ou navios ou avião usados em transporte internacional;

(III) Rendimento ou aluguer de contentores e respectivo equipamento usado no transporte internacional que seja inerente a operação internacional de um navio ou navios ou avião;

(IV) Ganhos da venda ou de outra alienação de um navio ou navios ou avião usados em transporte internacional;

(V) Rendimento obtido por indivíduo ou empresa que de alguma outra forma se dediquem a operação internacional de um navio ou navios ou avião através de participação activa em fundo comum aliança, joint venture, agência internacional ou outro empreendimento que se dedique ele próprio a operação internacional de um navio ou navios ou avião.

O Governo de Angola concorda com o conteúdo da nota acima transcrita e considera esse documento e esta resposta como constituindo um acordo entre os nossos dois Governos, e que deverá aplicar-se no ano fiscal 2006 bem como nos anteriores a que seja aplicável a Lei.

O Ministério das Relações Exteriores de Angola aproveita a oportunidade para expressar a certeza da sua mais elevada estima e consideração.

Luanda, aos 9 de Outubro de 2006

À
EMBAIXADA DOS ESTADOS
UNIDOS DA AMÉRICA

<u>LUANDA</u>

U.S. Department of State
Office of Language Services
Translating Division

LS No. 10-2007-0263
Portuguese/English
TGR/JPM

Translation

REPUBLIC OF ANGOLA
MINISTRY OF EXTERNAL RELATIONS
Office of the Deputy Minister

Note verbale No. 116/GVMRE/06

The Ministry of External Relations of Angola presents its compliments to the Embassy of the United States of America and has the honor to acknowledge receipt of the revised reply to its note No. 271/2005, proposing an exchange of notes to exempt from Angolan tax gross income derived from the international operation of a ship or ships or aircraft by corporations organized in the United States of America that are engaged in the international operation of a ship or ships or aircraft. This exemption shall be granted on the basis of equivalent exemptions granted by the United States to corporations[1] resident in Angola (other than United States citizens or corporations and corporations organized in Angola).

The Government of Angola, in accordance with the legal provisions contained in Article 13(1)(g) of the Angolan Industrial Tax Code (income tax), combined with Law No. 18/92 of July 3, which stipulates that foreign sea and aerial navigation companies shall be exempted from industrial tax if, in the country of their nationality, Angolan companies have the same prerogative, agrees to exempt from income tax gross

Embassy of the United States of America,
Luanda.

[1] Translator's note: Rendered "individuals" in Embassy Luanda's proposed model reply for GoA to note No. 271.

income derived from the international operation of a ship or ships or aircraft by corporations resident in the United States of America and corporations organized in the United States that are engaged in the international operation of a ship or ships or aircraft.

Gross income derived from the international operation of a ship or ships or aircraft includes:

I. Income from the rental on a full- (time or voyage) basis of a ship or ships or aircraft used in international transport;

II. Income from the rental, on a bareboat basis, of a ship or ships or aircraft used in international transport;

III. Income or [sic – typo; should be "do" (from) rather than "ou" (or)] rental of containers and related equipment used in international transport that is incidental to income form the international operation of a ship or ships or aircraft;

IV. Gains from the sale or other alienation of a ship or ships or aircraft used in international transport;

V. Income derived by an individual or corporation otherwise engaged in the international operation of a ship or ships or aircraft from active participation in a pool[,] an alliance, joint venture, international operating agency, or other venture that is itself engaged in the international operation of a ship or ships or aircraft.

The Government of Angola agrees to the proposal contained in the note transcribed above, and considers said document and this note in reply to constitute an

agreement between our two governments, which shall have effect with regards to taxable year 2006, and all prior ones to which it may apply.

[Complimentary close]

Luanda, October 9, 2006

[Initialed]

[Illegible stamp]

Part III. Administrative, Procedural, and Miscellaneous

Alternative Signature Methods for Electronic Return Originators

Notice 2007–79

SECTION I. PURPOSE

This notice provides that the Internal Revenue Service will allow Electronic Return Originators (EROs) to sign the following forms by rubber stamp, mechanical device (such as signature pen), or computer software program: Form 8453, *U.S. Individual Income Tax Declaration for an IRS e-file Return*; Form 8878, *IRS e-file Signature Authorization for Form 4868 or Form 2350*; and Form 8879, *IRS e-file Signature Authorization*.

SECTION 2. BACKGROUND

Section 6061 of the Internal Revenue Code and Treas. Reg. § 1.6061–1(a) generally provide that any tax return, statement, or other document shall be signed in accordance with forms, instructions, or regulations prescribed by the Secretary. Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*, sets forth the procedures for completing the Form 8453, Form 8878, and Form 8879. If providing the signature on a paper declaration, the taxpayer and the ERO (and the paid preparer if different from the ERO) must complete and sign the Form 8453 before the electronic data portion of the return is submitted. Taxpayers may wish to sign their returns electronically, but may choose to authorize their ERO to enter their Personal Identification Number (PIN) in the electronic return record by completing the appropriate IRS e-file signature authorization form. Form 8879 authorizes an ERO to enter PINs on Individual Income Tax Returns, and Form 8878 authorizes an ERO to enter PINs on Forms 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*; and Form 2350, *Application for Extension of Time To File U.S. Income Tax Return*.

SECTION 3. REQUIREMENTS FOR USE OF ALTERNATIVE METHODS OF SIGNING

The alternative methods of signing that this notice authorizes must include either a facsimile of the individual ERO's signature or of the ERO's printed name. EROs using one of these alternative means are personally responsible for affixing their signatures to returns or requests for extension.

This notice applies only to EROs that sign Form 8453, Form 8878, or Form 8879, and does not alter the signature requirements for any other type of document currently required to be manually signed, such as elections, applications for changes in accounting method, powers of attorney, or consent forms. In addition, this notice does not alter the requirement that Form 8453, Form 8878, or Form 8879 be signed by the taxpayer making these forms by handwritten signature or other authorized means.

SECTION 4. EFFECTIVE DATE

This notice applies to any Form 8453, Form 8878, or Form 8879 filed on or after October 15, 2007.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Michael E. Hara of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact Michael E. Hara at (202) 622–4910 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 62, 162, 267, 274; 1.62–2, 1.162–17, 1.267(a)–1, 1.274–5.)

Rev. Proc. 2007–63

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2006–41, 2006–43 I.R.B. 777, and provides rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses, or for meal and incidental expenses, incurred while traveling away from home are deemed substantiated under § 1.274–5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for the expenses. In addition, this revenue procedure provides an optional method for employees and self-employed individuals who are not reimbursed to use in computing the deductible costs paid or incurred for business meal and incidental expenses, or for incidental expenses only if no meal costs are paid or incurred, while traveling away from home. Use of a method described in this revenue procedure is not mandatory, and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of the travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service

limitations of the Department of Transportation, § 274(n)(3) gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008 or thereafter. For taxable years beginning in 2007, the deductible percentage for these expenses is 75 percent.

.03 Section 274(d) provides, in part, that no deduction is allowed under § 162 for any travel expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. Section 274(d) further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by the regulations.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or *per diem* allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which these arrangements or allowances, if in accordance with reasonable business practice, are regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of travel expenses for purposes of § 1.274–5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of travel expenses for purposes of § 1.274–5(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement is not treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein do not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for the expense.

.07 Under § 1.62–2(c), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan and are excluded from income and wages. If an arrangement does not meet these requirements, all amounts paid under the arrangement are treated as paid under a nonaccountable plan and are included in the employee's gross income, must be reported as wages or compensation on the employee's Form W–2, and are subject to the withholding and payment of employment taxes. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) or (j) is treated as substantiation of the amount of the expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing *per diem* allowances is treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of the allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return within a reasonable period of time any portion of the allowance that relates to days of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that, if a payor pays a *per diem* allowance that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g) or (j), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner has the discretion to prescribe special rules regarding the timing of withholding and payment of employment taxes on *per diem* allowances.

.10 Section 1.274–5(j)(1) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Section 1.274–5(j)(3) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for incidental expenses paid or incurred while traveling away from home in lieu of substantiating the actual cost of incidental expenses.

.12 Sections 3.02(1)(a), 4.04(6), and 5.06 of this revenue procedure provide transition rules for the last 3 months of calendar year 2007.

.13 Section 5.02 of this revenue procedure contains revisions to the *per diem* rates for high-cost localities and for other localities for purposes of section 5.

.14 Section 5.03 of this revenue procedure contains the list of high-cost localities and section 5.04 of this revenue procedure describes changes to the list of high-cost localities for purposes of section 5.

.15 Sections 7.10 and 8.06 of this revenue procedure refer to Rev. Rul. 2006–56, 2006–46 I.R.B. 874, which describes circumstances when a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder.

SECTION 3. DEFINITIONS

.01 *Per diem allowance.* The term "*per diem* allowance" means a payment under a

reimbursement or other expense allowance arrangement that is —

(1) paid with respect to ordinary and necessary business expenses incurred, or that the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses, or for meal and incidental expenses, for travel away from home in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable federal *per diem* rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate.*

(1) *In general.* The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates.* The rates for localities in the continental United States ("CONUS") are set forth in Appendix A to 41 C.F.R. ch. 301. However, in applying section 4.01, 4.02, or 4.03 of this revenue procedure, taxpayers may continue to use the CONUS rates in effect for the first 9 months of 2007 for expenses of all CONUS travel away from home that are paid or incurred during calendar year 2007 in lieu of the updated GSA rates. A taxpayer must consistently use either these rates or the updated rates for the period October 1, 2007, through December 31, 2007.

(b) *OCONUS rates.* The rates for localities outside the continental United States ("OCONUS") are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the *Per Diem* Supplement to the Standardized Regulations (Government Civilians, Foreign Areas) (updated on a monthly basis).

(c) *Internet access to the rates.* The CONUS and OCONUS rates may be found on the Internet at *www.gsa.gov*.

(2) *Locality of travel.* The term "locality of travel" means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses.* The term "incidental expenses" has the same meaning as in the Federal Travel Regulations, 41 C.F.R. 300–3.1 (2007). Thus, based on the current definition of "incidental expenses" in the Federal Travel Regulations, "incidental expenses" means fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries; transportation between places of lodging or business and places where meals are taken, if suitable meals can be obtained at the temporary duty site; and the mailing cost associated with filing travel vouchers and payment of employer-sponsored charge card billings.

.03 *Flat rate or stated schedule.*

(1) *In general.* Except as provided in section 3.03(2) of this revenue procedure, an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01 of this revenue procedure. The allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (such as cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation.* An allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (such as the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62–2(d), is not a *per diem* allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance, or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62–2(d)(3)(ii).

SECTION 4. *PER DIEM* SUBSTANTIATION METHOD

.01 *Per diem allowance.* If a payor pays a *per diem* allowance in lieu of reimbursing actual lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the federal *per diem* rate (see section 3.02 of this revenue procedure) for the locality of travel for that day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meal and incidental expenses only per diem allowance.* If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual meal and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the federal M&IE rate for the locality of travel for that day (or partial day). A *per diem* allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (such as the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meal and incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel

away from home, employees and self-employed individuals who pay or incur meal expenses may use an amount computed at the federal M&IE rate for the locality of travel for each calendar day (or partial day) the employee or self-employed individual is away from home. This amount will be deemed substantiated for purposes of paragraphs (b)(2) and (c) of § 1.274–5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with those regulations. See section 6.05(1) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.03. See section 4.05 of this revenue procedure for a method for substantiating incidental expenses that may be used by employees or self-employed individuals who do not pay or incur meal expenses.

.04 *Special rules for transportation industry.*

(1) *In general.* This section 4.04 applies to (a) a payor that pays a *per diem* allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Transportation industry defined.* For purposes of this section 4.04, an employee or self-employed individual is in the transportation industry only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is in the transportation industry by using a method that is consistently applied and in accordance with reasonable business practice.

(3) *Rates.* A taxpayer described in section 4.04(1) of this revenue procedure may treat $52 as the federal M&IE rate for any CONUS locality of travel, and $58 as the federal M&IE rate for any OCONUS locality of travel. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. See section 4.04(6) of this revenue procedure for transition rules.

(4) *Periodic rule.* A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue procedure periodically (not less frequently than monthly), rather than daily, by comparing the total *per diem* allowance paid for the period to the sum of the amounts computed either at the federal M&IE rate(s) for the localities of travel, or at the special rate described in section 4.04(3), for the days (or partial days) the employee is away from home during the period.

(5) *Examples.*

(a) *Example 1.* Taxpayer, an employee in the transportation industry, travels away from home on business within CONUS on 17 days (including partial days) during a calendar month and receives a *per diem* allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(3) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total *per diem* allowance paid for the month or $884 (17 days at $52 per day).

(b) *Example 2.* Taxpayer, a truck driver employee in the transportation industry, is paid a "cents-per-mile" allowance that qualifies as an allowance paid under a flat rate or stated schedule as defined in section 3.03 of this revenue procedure. Taxpayer travels away from home on business for 10 days. Based on the number of miles driven by Taxpayer, Taxpayer's employer pays an allowance of $500 for the 10 days of business travel. Taxpayer actually drives for 8 days, and does not drive for the other 2 days Taxpayer is away from home. Taxpayer is paid under the periodic rule used for transportation industry employers and employees in accordance with section 4.04(4) of this revenue procedure. The amount deemed substantiated is the full $500 because that amount does not exceed $520 (ten days away from home at $52 per day).

(6) *Transition rules.* Under the calendar-year convention provided in section 4.04(3), a taxpayer who used the federal M&IE rates during the first 9 months of calendar year 2007 to substantiate the amount of an individual's travel expenses under sections 4.02 or 4.03 of Rev. Proc. 2006–41 may not use, for that individual, the special transportation industry rates provided in this section 4.04 until January 1, 2008. Similarly, a taxpayer who used the special transportation industry rates during the first 9 months of calendar year 2007 to substantiate the amount of an individual's travel expenses may not use, for that individual, the federal M&IE rates until January 1, 2008.

.05 *Optional method for incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who do not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may use, for each calendar day (or partial day) the employee or self-employed individual is away from home, an amount computed at the rate of $3 per day for any CONUS or OCONUS locality of travel. This amount will be deemed substantiated for purposes of paragraphs (b)(2) and (c) of § 1.274–5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with those regulations. See section 4.03 of this revenue procedure for a method that may be used by employees or self-employed individuals who pay or incur meal expenses. The method authorized by this section 4.05 may not be used by payors that use section 4.01, 4.02, or 5.01 of this revenue procedure, or by employees or self-employed individuals who use the method described in section 4.03 of this revenue procedure. See section 6.05(4) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.05.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *In general.* If a payor pays a *per diem* allowance in lieu of reimbursing ac-

tual lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for that day (or partial day, see section 6.04 of this revenue procedure). Except as provided in section 5.06 of this revenue procedure, this high-low substantiation method may be used in lieu of the *per diem* substantiation method provided in section 4.01 of this revenue procedure, but may not be used in lieu of the meal and incidental expenses only *per diem* substantiation method provided in section 4.02 of this revenue procedure.

.02 *Specific high-low rates.* Except as provided in section 5.06 of this revenue procedure, the *per diem* rate set forth in this section 5.02 is $237 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $152 for travel to any other locality within CONUS. The high or low rate, as appropriate, applies as if it were the federal *per diem* rate for the locality of travel. For purposes of applying the high-low substantiation method and the § 274(n) limitation on meal expenses (see section 6.05(3) of this revenue procedure), the amount of the high and low rates that is treated as paid for meals is $58 for a high-cost locality and $45 for any other locality within CONUS.

.03 *High-cost localities.* The following localities have a federal *per diem* rate of $194 or more, and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parentheses under the key city name:

Key City	*County or other defined location*
Arizona	
Phoenix/Scottsdale (January 1-March 31)	Maricopa
Sedona (March 1-April 30)	City Limits of Sedona
California	
Napa	Napa
Palm Springs (January 1-April 30)	Riverside
San Diego	San Diego
San Francisco	San Francisco
Santa Barbara	Santa Barbara
Santa Monica	City limits of Santa Monica
South Lake Tahoe (December 1-March 31)	El Dorado
Yosemite National Park	Mariposa
Colorado	
Aspen (December 1-April 30)	Pitkin
Crested Butte/Gunnison (December 1-March 31)	Gunnison
Silverthorne/Breckenridge (December 1-March 31)	Summit
Steamboat Springs (December 1-February 29)	Routt
Telluride (October 1-March 31)	San Miguel
Vail	Eagle
District of Columbia	
Washington, D.C. (also the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland) (See also Maryland and Virginia)	

Key City	*County or other defined location*
Florida	
Fort Lauderdale (October 1-April 30)	Broward
Fort Walton Beach/De Funiak Springs (June 1-July 31)	Okaloosa and Walton
Key West	Monroe
Miami (October 1-February 29)	Miami-Dade
Naples (February 1-March 31)	Collier
Palm Beach (January 1-March 31)	Boca Raton, Delray Beach, Jupiter, Palm Beach Gardens, Palm Beach, Palm Beach Shores, Singer Island and West Palm Beach
Stuart (February 1-March 31)	Martin
Illinois	
Chicago	Cook and Lake
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Baltimore City	Baltimore
Cambridge/St. Michaels (April 1-August 31)	Dorchester and Talbot
Ocean City (June 1-August 31)	Worcester
Massachusetts	
Boston/Cambridge	Suffolk, City of Cambridge
Martha's Vineyard (July 1-August 31)	Dukes
Nantucket	Nantucket
Nevada	
Incline Village/Crystal Bay/Reno/Sparks (June 1-August 31)	Washoe
New Hampshire	
Conway (July 1-August 31)	Caroll
New York	
Floral Park/Garden City/Glen Cove/Great Neck/Roslyn	Nassau
Manhattan	The Boroughs of Manhattan, Brooklyn, the Bronx and Staten Island
Queens	Queens
Saratoga Springs/Schenectady (July 1-August 31)	Saratoga and Schenectady
Tarrytown/White Plains/New Rochelle/Yonkers	Westchester
Pennsylvania	
Philadelphia	Philadelphia

Key City	County or other defined location
Rhode Island	
Jamestown/Middletown/Newport (October 1-November 30 and February 1-September 30)	Newport
Providence	Providence
Utah	
Park City (January 1-March 31)	Summit
Virginia	
(For the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington and Fairfax, see District of Columbia)	
Loudon County	Loudon
Virginia Beach (June 1-August 31)	City of Virginia Beach
Washington	
Seattle	King
Wisconsin	
Lake Geneva (June 1-September 30)	Walworth

.04 *Changes in high-cost localities*. The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2006–41 (changes listed by key cities).

(1) The following localities have been added to the list of high-cost localities: Sedona, Arizona; Napa, California; Palm Springs, California; San Diego, California; Yosemite National Park, California; Silverthorne/Breckenridge, Colorado; Incline Village/Crystal Bay/Reno/Sparks, Nevada; Conway, New Hampshire; Tarrytown/White Plains/New Rochelle/Yonkers, New York; Loudon County, Virginia; Virginia Beach, Virginia; and Lake Geneva, Wisconsin.

(2) The portion of the year for which the following are high-cost localities has been changed: Santa Barbara, California; Crested Butte/Gunnison, Colorado; Steamboat Springs, Colorado; Telluride, Colorado; Vail, Colorado; Fort Lauderdale, Florida; Miami, Florida; Palm Beach, Florida; Cambridge/St. Michaels, Maryland; Ocean City, Maryland; Nantucket, Massachusetts; Jamestown/Middletown/Newport, Rhode Island; and Park City, Utah.

(3) The following localities have been removed from the list of high-cost localities: New Orleans, Louisiana and Lake Placid, New York.

.05 *Specific limitation*.

(1) Except as provided in section 5.05(2) of this revenue procedure, a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. See section 5.06 of this revenue procedure for transition rules.

(2) With respect to an employee described in section 5.05(1) of this revenue procedure, the payor may reimburse actual expenses or use the meal and incidental expenses only *per diem* substantiation method described in section 4.02 of this revenue procedure for any travel away from home, and may use the *per diem* substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

.06 *Transition rules*. A payor who used the substantiation method of section 4.01 of Rev. Proc. 2006–41 for an employee during the first 9 months of calendar year 2007 may not use the high-low substantiation method in section 5 of this revenue procedure for that employee until January 1, 2008. A payor who used the high-low substantiation method of section 5 of Rev. Proc. 2006–41 for an employee during the first 9 months of calendar year 2007 must continue to use the high-low substantiation method for the remainder of calendar year 2007 for that employee. A payor described in the previous sentence may use the rates and high-cost localities published in section 5 of Rev. Proc. 2006–41, in lieu of the updated rates and high-cost localities provided in section 5 of this revenue procedure, for travel on or after October 1, 2007, and before January 1, 2008, if those rates and localities are used consistently during this period for all employees reimbursed under this method.

SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general*. The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301–11 (2007), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate*. A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the require-

ment that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate.* A payor is not required to reduce the federal *per diem* rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee during each day of travel.

.04 *Proration of the federal per diem or M&IE rate.* Pursuant to the Federal Travel Regulations, in determining the federal *per diem* rate or the federal M&IE rate for the locality of travel, the full applicable federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. The method described in section 6.04(1) of this revenue procedure must be used for purposes of determining the amount deemed substantiated under section 4.03 or 4.05 of this revenue procedure for partial days of travel away from home. For purposes of determining the amount deemed substantiated under section 4.01, 4.02, 4.04, or 5 of this revenue procedure for partial days of travel away from home, either of the following methods may be used to prorate the federal M&IE rate to determine the federal *per diem* rate or the federal M&IE rate for the partial days of travel:

(1) The rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual. The same ratio may be applied to prorate the allowance for incidental expenses described in section 4.05 of this revenue procedure; or

(2) The rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to two times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only one and a half times the federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses.* Except as provided in section 6.05(4), all or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) If an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat that amount as an expense for food and beverages.

(2) If a *per diem* allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the federal M&IE rate for the locality of travel for each day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) If a *per diem* allowance is paid for lodging, meal, and incidental expenses for each calendar day (or partial day) the employee is away from home at a rate equal to or in excess of the federal *per diem* rate for the locality of travel, the payor must treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day) as an expense for food or beverages.

(4) If a *per diem* allowance is paid for lodging, meal, and incidental expenses for each calendar day (or partial day) the employee is away from home at a rate less than the federal *per diem* rate for the locality of travel, the payor must:

(a) treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day) or, if less, the amount of the allowance, as an expense for food or beverages; or

(b) treat an amount equal to 40 percent of the allowance as an expense for food or beverages.

(5) If an amount for incidental expenses is computed under section 4.05 of this revenue procedure, none of the amount so computed is subject to limitation under § 274(n) on the deductibility of food and beverage expenses.

.06 *No double reimbursement or deduction.* If a payor pays a *per diem* allowance in lieu of reimbursing actual lodging, meal, and incidental expenses, or meal and incidental expenses, in accordance with section 4 or 5 of this revenue procedure, and such amounts are treated as paid under an accountable plan, any additional payment with respect to those expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to those expenses. For example, assume an employee receives a *per diem* allowance from a payor for lodging, meal, and incidental expenses, or for meal and incidental expenses, incurred while traveling away from home and such amounts are treated as paid under an accountable plan. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a *per diem* allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes.

.07 *Related parties.* Sections 4.01 and 5 of this revenue procedure do not apply if a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) is 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee substantiates to the payor the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274–5, the

employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). See also § 1.62–2(e)(1) for the rule that in order to satisfy the substantiation requirement of an accountable plan, an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.02 An arrangement providing *per diem* allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) of returning amounts in excess of expenses if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of the allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of the allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance *per diem* allowance for meal and incidental expenses of $250, based on an anticipated 5 days of business travel at $50 per day to a locality for which the federal M&IE rate is $39, and the employee substantiates 3 full days of business travel. The requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel ($100), even though the employee is not required to return the portion of the allowance ($33) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($117) for the 3 substantiated days of travel. However, the $33 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a *per diem* allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. See § 1.274–5(f)(2)(i). Assuming that the remaining requirements for an accountable plan provided in § 1.62–2 are satisfied, that portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W–2, and is exempt from the withholding and payment of employment taxes. See § 1.62–2(c)(2) and (c)(4).

.04 An employee is required to include in gross income only the portion of the *per diem* allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. See § 1.274–5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes. See § 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses (not just the excess over the federal *per diem* rate), includes on Form 2106, "*Employee Business Expenses*," the deemed substantiated portion of the *per diem* allowance received from the payor, and includes in gross income the portion (if any) of the *per diem* allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274–5(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who pays or incurs amounts for meal expenses and does not receive a *per diem* allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67. See section 7.07 of this revenue procedure for the treatment of an employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses.

.07 An employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses may deduct an amount computed pursuant to section 4.05 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67. See section 7.06 of this revenue procedure for the treatment of an employee who pays or incurs amounts for meal expenses and does not receive a *per diem* allowance for meal and incidental expenses.

.08 A self-employed individual who pays or incurs meal expenses for a calendar day (or partial day) of travel away from home may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation on meal and entertainment expenses provided in § 274(n).

.09 A self-employed individual who does not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may deduct an amount computed pursuant to section 4.05 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.10 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. See § 1.62–2(k) and Rev. Rul.

2006–56. Thus, these payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. See § 1.62–2(c)(3), (c)(5), and (h)(2), and section 8.06 of this revenue procedure.

SECTION 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES

.01 The portion of a *per diem* allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is treated as paid under a nonaccountable plan and is subject to withholding and payment of employment taxes. See § 1.62–2(h)(2)(i)(B).

.02 In the case of a *per diem* allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days of travel substantiated. See § 1.62–2(h)(2)(i)(B)(2).

.03 In the case of a *per diem* allowance paid as an advance, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the days of travel with respect to which the advance was paid are substantiated. See § 1.62–2(h)(2)(i)(B)(3). If some or all of the days of travel with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those days within a reasonable period of time, the portion of the allowance that relates to those days is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)(2)(i)(A).

.04 In the case of a *per diem* allowance only for meal and incidental expenses for travel away from home paid to an employee in the transportation industry by a payor that uses the rule in section 4.04(4) of this revenue procedure, the excess of the *per diem* allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(4) of this revenue procedure), is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62–2(h)(2)(i)(B)(4).

.05 For example, assume that an employer pays an employee a *per diem* allowance under an arrangement that otherwise meets the requirements of an accountable plan to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the federal *per diem* rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the federal *per diem* rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the federal *per diem* rate is $160 and 4 days in a locality in which the federal *per diem* rate is $120. The employer reimburses the employee $960 for the 6 days of travel away from home (2 x (120% x $160) + 4 x (120% x $120)), and does not require the employee to return the excess payment of $160 (2 days x $32 ($192-$160) + 4 days x $24 ($144-$120)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on $160. See section 8.02 of this revenue procedure.

.06 If a *per diem* allowance arrangement has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and the arrangement routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all the expenses or repayment of the excess amount, the failure of the arrangement to treat the excess allowances as wages for employment tax purposes causes all payments made under the arrangement to be treated as made under a nonaccountable plan. See Rev. Rul. 2006–56.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for *per diem* allowances for lodging, meal and incidental expenses, or for meal and incidental expenses only, that are paid to an employee on or after October 1, 2007, with respect to travel away from home on or after October 1, 2007. For purposes of computing the amount allowable as a deduction for travel away from home, this revenue procedure is effective for meal and incidental expenses or for incidental expenses only paid or incurred on or after October 1, 2007.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–41 is superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeffrey T. Rodrick of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Rodrick at (202) 622–4930 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 442, 898; 1.442–1.)

Rev. Proc. 2007–64

SECTION 1. PURPOSE

This revenue procedure modifies a scope provision and one of the terms and conditions under which the Internal Revenue Service grants approval of requests by corporations for changes in annual accounting periods filed under Rev. Proc. 2006–45, 2006–45 I.R.B. 851. Specifically, this revenue procedure modifies the scope provision regarding a corporation that exits a consolidated group. See section 4.02(13) of Rev. Proc. 2006–45. In addition, this revenue procedure modifies the terms and conditions relating to recordkeeping and book conformity in the case of a controlled foreign corporation ("CFC") that has a majority U.S. shareholder year (as defined in § 898(c)(3) of the Internal Revenue Code) and that is changing to a one-month deferral year described in § 898(c)(2) or to a 52–53-week taxable year that references such one-month deferral year. See section 6.02 of Rev. Proc. 2006–45.

SECTION 2. BACKGROUND

.01 Section 442 and § 1.442–1(a) of the Income Tax Regulations generally provide that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

.02 Section 1.442–1(b)(2) provides that a change in annual accounting period will be approved only if the taxpayer agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the change.

.03 Rev. Proc. 2006–45 provides the exclusive procedures for certain corporations to obtain automatic approval of the Commissioner to change their annual accounting periods.

.04 Section 4.02(13) of Rev. Proc. 2006–45 excludes from the scope of the revenue procedure a corporation that ceases to be a member of a consolidated group during the consolidated group's first effective year (as defined in section 5.05 of Rev. Proc. 2006–45).

.05 The Service has determined that it is appropriate to modify the scope of Rev. Proc. 2006–45 to clarify that any corporation leaving a consolidated group is excluded from the automatic change procedures under Rev. Proc. 2006–45 during the consolidated group's taxable year (without regard to a change in the consolidated group's accounting period) in which the corporation ceases to be a member of the consolidated group. A corporation that ceases to be a member of a consolidated group must continue to use the annual accounting period of the consolidated group, unless the corporation receives approval under Rev. Proc. 2002–39, 2002–1 C.B. 1046, to change its annual accounting period (or is required to change its annual accounting period upon joining another consolidated group).

.06 Section 898(c)(2) provides that a specified foreign corporation (*i.e.*, a CFC) may elect, in lieu of the taxable year under § 898(c)(1)(A) (*i.e.*, the majority U.S. shareholder year as defined in § 898(c)(3)), a taxable year beginning one month earlier than the majority U.S. shareholder year (*i.e.*, one-month deferral year described in § 898(c)(2)).

.07 Section 4.02(8) of Rev. Proc. 2006–45 includes in the scope of the revenue procedure a CFC that has a majority U.S. shareholder year and that is changing to a one-month deferral year or to a 52–53-week taxable year that references such one-month deferral year.

.08 With respect to the terms and conditions of change under Rev. Proc. 2006–45, section 6.02(1) of that revenue procedure generally requires that a corporation compute its income and keep its books and records (including financial statements and reports to creditors) on the basis of the requested taxable year. That section further requires that the books and records of the corporation be closed as of the last day of the first effective year and that the corporation conform the accounting period used for financial statement purposes and reports to creditors concurrently.

.09 The Service has determined that in the case of a CFC changing to a one-month deferral year or to a 52–53-week taxable year that references such one-month deferral year, the CFC is not required to issue financial statements and reports to creditors on the basis of the requested year as otherwise required by section 6.02(1) of Rev. Proc. 2006–45. However, as required by section 6.02(1) of Rev. Proc. 2006–45, the CFC must close its books and records as of the last day of the first effective year and, every year after the first effective year, must close its books and records as of the last day of the requested taxable year, either a one-month deferral year or a 52–53-week taxable year that references such one-month deferral year. The CFC must also compute its income and earnings and profits for U.S. tax purposes on the basis of the requested year.

SECTION 3. SCOPE

.01 *Corporations leaving a consolidated group.* This revenue procedure applies to a corporation leaving a consolidated group that wants to change its annual accounting period in the year the corporation ceases to be a member of the consolidated group.

.02 *CFCs changing to one-month deferral year or to a 52–53-week taxable year that references such one-month deferral year.* This revenue procedure also applies to a CFC that has a majority U.S. shareholder year, and that is properly applying under Rev. Proc. 2006–45 to change to a one-month deferral year or to a 52–53-week taxable year that references such one-month deferral year.

SECTION 4. MODIFICATIONS

.01 Section 4.02(13) is modified to read as follows: "*Corporation that exits a consolidated group.* A corporation that ceases to be a member of a consolidated group and wants to change its annual accounting period during the consolidated group's taxable year in which the corporation ceases to be a member of the consolidated group. For purposes of the prior sentence, the consolidated group's taxable year is determined without regard to a change in the consolidated group's annual accounting period. A corporation that ceases to be a member of a consolidated group must continue to use the annual accounting period of the consolidated group, unless the corporation receives approval under Rev. Proc. 2002–39 to change its annual accounting period (or is required to change its annual accounting period upon joining another consolidated group). A corporation that ceases to be a member of a consolidated group during the consolidated group's first effective year is not a member of the consolidated group for purposes of the consolidated group's change in accounting period. See section 7.02(7) of this revenue procedure.

(a) *Example 1.* On March 31, 2006, ABC Corporation ceases to be a member of a consolidated group that has a taxable year ending on November 30. ABC Corporation is not eligible to change its annual accounting period under this revenue procedure to a taxable year beginning before December 1, 2006.

(b) *Example 2.* Assume the same facts as *Example 1*, except that the consolidated group changes its annual accounting period to a taxable year ending on August 31, effective August 31, 2006. ABC Corporation is not eligible to change its annual accounting period under this revenue procedure to a taxable year beginning before December 1, 2006.

(c) *Example 3.* Assume the same facts as *Example 2*, except that the consolidated group changes its annual accounting period to a taxable year ending on January 31, effective January 31, 2006. ABC Corporation is not eligible to change its annual accounting period under this revenue procedure to a taxable year beginning before February 1, 2007."

.02 Section 6.02 of Rev. Proc. 2006–45 is modified to add paragraph (4) as follows: "(4) *CFCs changing to a year described in § 898(c)(2) or to a 52–53-week taxable year that references such one-month deferral year.* The terms and conditions regarding financial statements and reports to creditors in section

6.02(1) of this revenue procedure do not apply in the case of a CFC that has a majority U.S. shareholder year (as defined in § 898(c)(3)), and that is changing to a one-month deferral year described in § 898(c)(2) or to a 52–53-week taxable year that references such one-month deferral year. Such a CFC is nevertheless required to close its books and records as of the last day of the first effective year and every year thereafter to close its books and records on the last day of the requested taxable year, and to compute its income and earnings and profits for U.S. tax purposes on the basis of the requested taxable year.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–45 is modified and clarified.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for changes in annual accounting periods for which the first effective year (as defined in section 5.05 of Rev. Proc. 2006–45) ends on or after October 18, 2006.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeffrey S. Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Marshall at (202) 622–4960 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Benefit Restrictions for Underfunded Pension Plans

REG–113891–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing guidance regarding the use of certain funding balances maintained for defined benefit pension plans and regarding benefit restrictions for certain underfunded defined benefit pension plans. The proposed regulations reflect changes made by the Pension Protection Act of 2006. These regulations affect sponsors, administrators, participants, and beneficiaries of single employer defined benefit pension plans.

DATES: Written or electronic comments and requests for a public hearing must be received by November 28, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–113891–07), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. to 4 p.m. to CC:PA:LPD:PR (REG–113891–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–113891–07).

FOR FURTHER INFORMATION CONTACT: Lauson C. Green or Linda S.F. Marshall at (202) 622–6090; concerning submissions and requests for a public hearing, contact Kelly Banks at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by October 29, 2007. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.430(f)–1(f) and §§1.436–1(f) and 1.436–1(h). This information is required in order for a qualified defined benefit plan's enrolled actuary to provide a timely certification of the plan's AFTAP for each plan year to avoid certain benefit restrictions. In addition, these proposed regulations provide for several written elections to be made by the plan sponsor upon occasion. This information is voluntary to obtain a benefit. The likely respondents are qualified retirement plan sponsors and enrolled actuaries.

Estimated total annual reporting burden: 60,000 hours.

Estimated average annual burden hours per respondent: 0.75 hours.

Estimated number of respondents: 80,000.

Estimated annual frequency of responses: occasional.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed Income Tax Regulations (26 CFR part 1) under sections 430(f) and 436, as added to the Code by the Pension Protection Act of 2006 (PPA '06), Public Law 109–280, 120 Stat. 780.

Section 412 contains minimum funding rules that generally apply to defined benefit plans.[1] The minimum funding rules that apply specifically to single employer defined benefit plans (including multiple employer plans within the meaning of section 413(c)) are set forth in new section 430.

Section 430 generally provides that the minimum required contribution for a year is the sum of the target normal cost for the year and the shortfall and waiver amortization charges. Under section 430(f)(3), certain funding balances referred to as the prefunding balance and the funding standard carryover balance are permitted to be used to reduce the otherwise applica-

[1] Section 302 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), sets forth funding rules that are parallel to those in section 412 of the Code, section 303 of ERISA sets forth additional funding rules for defined benefit plans (other than multiemployer plans) that are parallel to those in section 430 of the Code, and section 206(g) of ERISA sets forth funding-based limitations for defined benefit plans (other than multiemployer plans) that are parallel to those in section 436 of the Code. Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713) and section 302 of ERISA, the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in these proposed regulations for purposes of ERISA, as well as the Code. Thus, these proposed Treasury regulations issued under sections 430(f) and 436 of the Code apply as well for purposes of ERISA sections 303(f) and 206(g), respectively.

ble minimum required contribution for a plan year in certain situations. Under section 430(f)(7), the funding standard carryover balance is based on the funding standard account credit balance as determined under section 412 for a plan as of the last day of the last plan year beginning in 2007. Under section 430(f)(6), the prefunding balance represents the accumulation of the contributions that an employer makes for a plan year that exceed the minimum required contribution for the year. Thus, an employer that makes additional contributions for a plan year is permitted in certain circumstances to use those excess contributions in order to satisfy the minimum funding requirement in a subsequent plan year.

The treatment of these balances under section 430 reflects congressional concern with the treatment of a funding standard account credit balance under the section 412 rules in effect prior to PPA '06. Accordingly, section 430(f)(3) sets forth new limits on the ability of a poorly funded plan to use the prefunding balance and the funding standard carryover balance for a plan year. In addition, section 430(f)(4) requires that the prefunding balance and the funding standard carryover balance be subtracted from the value of plan assets for certain purposes (including the determination of the plan's funding target attainment percentage (FTAP), as defined under section 430(d)(2)) and section 430(f)(8) requires that the prefunding balance and the funding standard carryover balance be adjusted for actual investment return on the plan assets. In order to give employers the opportunity to minimize the impact of the requirement to subtract the prefunding balance and funding standard carryover balance from the plan assets, section 430(f)(5) permits an employer to elect to reduce the balances.

Section 401(a)(29) requires that a defined benefit plan (other than a multiemployer plan) satisfy the requirements of section 436. Section 436 sets forth a series of limitations on the accrual and payment of benefits under an underfunded plan. Under section 436(g), these limitations (other than the limitations on accelerated benefit payments under section 436(d)) do not apply to a plan for the first 5 plan years of the plan, taking into account any predecessor plan.

Section 436(b) sets forth a limitation on plant shutdown and other unpredictable contingent event benefits in situations where the plan's adjusted funding target attainment percentage (AFTAP) for the plan year is less than 60 percent or would be less than 60 percent taking into account the occurrence of the event. For this purpose, an "unpredictable contingent event benefit" means any benefit payable solely by reason of (1) a plant shutdown (or a similar event) or (2) an event other than attainment of age, performance of service, receipt or derivation of compensation, or the occurrence of death or disability. Under section 436(b)(2), the limitation does not apply for a plan year if the plan sponsor makes a specified contribution (in addition to any minimum required contribution). If the AFTAP for a plan year is less than 60 percent, then the specified contribution is equal to the amount of the increase in the plan's funding target for the plan year attributable to the occurrence of the event. If the AFTAP for a plan year is 60 percent or more but would be less than 60 percent taking into account the occurrence of the event, then the specified contribution is the amount sufficient to result in an AFTAP of 60 percent taking into account the occurrence of the event.

Under section 436(c), a plan amendment that has the effect of increasing the liabilities of the plan by reason of any increase in benefits (including changes in vesting) may not take effect if the plan's AFTAP for the plan year is less than 80 percent or would be less than 80 percent taking into account the amendment. Under section 436(c)(2), the limitation does not apply for a plan year if the plan sponsor makes a specified contribution (in addition to any minimum required contribution). If the plan's AFTAP for the plan year is less than 80 percent, then the specified contribution is equal to the amount of the increase in the plan's funding target for the plan year attributable to the amendment. If the plan's AFTAP for the plan year is 80 percent or more but would be less than 80 percent taking into account the amendment, then the specified contribution is the amount sufficient to result in an AFTAP of 80 percent taking into account the amendment. In addition, under section 436(c)(3), the limitation does not apply to an amendment that provides for a benefit increase under a formula not based on compensation, but only if the rate of increase does not exceed the contemporaneous rate of increase in average wages of the participants covered by the amendment.

Under section 436(d), a plan is required to set forth certain limitations on accelerated benefit distributions. If the plan's AFTAP for a plan year is less than 60 percent, the plan must not make any prohibited payments after the valuation date for the plan year. If the plan's AFTAP for a plan year is at least 60 percent but is less than 80 percent, the plan must not pay any prohibited payment to the extent the payment exceeds the lesser of (1) 50 percent of the amount otherwise payable under the plan and (2) the present value of the maximum PBGC guarantee with respect to a participant. In addition, if the plan sponsor is in bankruptcy proceedings, the plan may not pay any prohibited payment unless the plan's enrolled actuary certifies that the AFTAP of the plan is at least 100 percent. However, section 436(d) does not apply to a plan for a plan year if the terms of the plan provide for no benefit accruals with respect to any participant for the period beginning on September 1, 2005, and extending throughout the plan year.

Under section 436(d)(5), a "prohibited payment" is (1) any payment, in excess of the monthly amount paid under a single life annuity (plus any social security supplements that are provided under the plan), to a participant or beneficiary, (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits (an annuity contract), or (3) any other payment specified by the Secretary by regulations.

Under section 436(e), a plan is required to provide that if the plan's AFTAP is less than 60 percent for a plan year, all future benefit accruals under the plan must cease as of the valuation date for the plan year. Under section 436(e)(2), the limitation ceases to apply with respect to any plan year, effective as of the first day of the plan year, if the plan sponsor makes a contribution (in addition to any minimum required contribution for the plan year) equal to the amount sufficient to result in an AFTAP of 60 percent.

Section 436(f) sets forth a series of rules under which the limitations of section 436 will not apply to a plan. Under section 436(f)(1), an employer is permitted to provide security to the plan (in the form of a

surety bond, cash, or other forms satisfactory to the Treasury Department and the parties involved) that is treated as an asset of the plan for purposes of determining the plan's AFTAP. Under section 436(f)(2), if an employer uses the option in section 436(b)(2), 436(c)(2), or 436(e)(2) to make the specified contribution that would avoid a limitation under section 436, the specified contribution must be an actual contribution and the employer may not use a prefunding balance or funding standard carryover balance in lieu of making the specified contribution. In addition, a contribution to avoid a benefit limitation is disregarded in determining whether the minimum required contribution under section 430 has been made and in determining the plan's prefunding balance.

Section 436(f)(3) describes certain situations in which an employer is deemed to have made the election in section 430(f)(5) to reduce the plan's funding standard carryover balance or prefunding balance. Such an election has the effect of increasing the plan's FTAP (because the result of the election is a higher asset value used to determine the FTAP) and could lead to the plan not being subject to a benefit limitation under section 436. In particular, if the limitation under section 436(d) would otherwise apply to a plan, the plan sponsor is treated as having made an election (a deemed election) to reduce any prefunding balance or funding standard carryover balance by the amount necessary to prevent the benefit limitation from applying. A comparable rule applies to the other benefit limitations under sections 436(b), 436(c), and 436(e), but only in the case of a plan maintained pursuant to a collective bargaining agreement. In either case, this deeming rule applies only if the prefunding balance and funding standard carryover balances are large enough to avoid the application of a section 436 limitation.

Section 436(h) sets forth a series of presumptions that apply during the portion of the plan year that is before the plan's enrolled actuary has certified the plan's AFTAP for the year. Under section 436(h)(1), if a plan was subject to a limitation under section 436(b), 436(c), 436(d), or 436(e) for the plan year preceding the current plan year, the plan's AFTAP for the current year is presumed to be the same as for the preceding year until the plan's enrolled actuary certifies the plan's AFTAP for the current year. Under section 436(h)(3), if any of these limitations did not apply to the plan for the preceding year, but the plan's AFTAP for the preceding year was within 10 percentage points of the limitation's threshold, the plan's AFTAP is presumed to be reduced by 10 percentage points as of the first day of the 4th month of the current plan year, unless the plan's enrolled actuary has certified the plan's AFTAP for the current year by that day (and that day is deemed to be the plan's valuation date for purposes of applying the benefit limitations). If the plan's enrolled actuary has not certified the plan's AFTAP by the first day of the 10th month of the current plan year, section 436(h)(2) provides that the plan's AFTAP is conclusively presumed to be less than 60 percent as of that day (and that day is deemed to be the valuation date for purposes of applying the benefit limitations).

Under section 436(i), unless the plan provides otherwise, if a limitation on prohibited payments or future benefit accruals under section 436(d) or (e) ceases to apply to a plan, all such payments and benefit accruals resume, effective as of the day following the close of the limitation period.

Section 436(j) provides definitions that are used under section 436, including the plan's AFTAP. In general, the plan's AFTAP is based on the plan's FTAP for the plan year. However, the plan's AFTAP is determined by adding the aggregate amount of purchases of annuities for employees other than highly compensated employees (within the meaning of section 414(q)) made by the plan during the two preceding plan years to the numerator and the denominator of the fraction used to determine the FTAP.

In addition, section 436(j)(3) provides a special rule which applies to certain well-funded plans under which the plan's FTAP for purposes of section 436 (and hence the plan's AFTAP) is determined by using the plan's assets without reduction for the prefunding balance and the funding standard carryover balance. Section 436(j)(3)(B) sets forth a transition rule for determining eligibility for this special rule.

Section 436(k) provides that, for plan years that begin in 2008, the determination of the plan's FTAP for the preceding year is to be made pursuant to guidance issued by the Secretary.

Explanation of Provisions

I. *Section 430(f) — Effect of Prefunding Balance and Funding Standard Carryover Balance.*

A. *Overview.*

1. *In general.*

The proposed regulations would be the second in a series of proposed regulations under new section 430.[2] These regulations would provide guidance on the application of section 430(f), relating to the establishment and maintenance of a funding standard carryover balance and a prefunding balance for purposes of sections 430 and 436. The Treasury Department and the IRS intend to issue additional proposed regulations relating to other portions of the rules under section 430 later in 2007.

2. *Multiple employer plans.*

The proposed regulations under section 430(f) apply to plans subject to section 412 that are maintained by one employer or a controlled group of employers and to multiple employer plans within the meaning of section 413(c). In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules under the proposed regulations would be applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, each employer under such a multiple employer plan may have a separate funding standard carryover balance and a prefunding balance for the plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the proposed regulations under section 430(f) would apply as if all participants in the plan were employed by a single employer.

[2] Proposed regulation §§1.430(h)(3)–1 and 1.430(h)(3)–2, relating to the mortality tables used to determine liabilities under section 430(h)(3), were issued May 29, 2007 (REG–143601–06, 2007–24 I.R.B. 1398 [72 FR 29456]).

B. *Establishment of prefunding balance and funding standard carryover balance.*

The proposed regulations would provide that an employer is permitted to establish a prefunding balance for a plan that represents the accumulation of contributions made for plan years beginning on or after the effective date of section 430 with respect to the plan (the first effective plan year) that are in excess of the minimum required contributions (determined without regard to the prefunding balance and funding standard carryover balance) for those plan years. Specifically, for the first effective plan year of a plan, the prefunding balance is initialized at zero dollars and an employer is permitted to elect to add some or all of the excess contributions made to a plan for each plan year to the prefunding balance as of the first day of the next plan year. For this purpose, the excess contributions are generally determined as the amount by which the employer contributions to the plan for the plan year exceed the minimum required contribution for the plan year, with appropriate adjustments for interest determined at the effective interest rate under section 430(h)(2)(A). However, the proposed regulations would provide that any contribution that is made to avoid the application of a benefit limitation under section 436 is not taken into account in determining the amount of excess contributions.

The proposed regulations would also provide that the minimum required contribution for purposes of determining the amount of excess contributions for the year is determined without regard to any offset of the minimum required contribution for the year as a result of the use of the prefunding or funding standard carryover balances. Accordingly, an employer would not be permitted to add to the prefunding balance any amount of contributions that are "excess" by reason of an offset of the minimum required contribution for the year through the use of the prefunding balance or funding standard carryover balance. This prohibition precludes an employer from avoiding the requirement to adjust the prefunding balance and funding standard carryover balance by the actual rate of return on plan assets in the situation where the plan assets have experienced a loss (or a rate of return that is lower than the effective interest rate that is used for interest adjustments with respect to minimum required contributions for the plan year).

The proposed regulations would provide that the funding standard carryover balance is initialized as the balance in the funding standard account as of the last day of the last plan year before section 430 applies to a plan (the pre-effective plan year). This is generally the last plan year beginning in 2007, but could be a later year in the case of a plan to which a delayed effective date applies under the rules of sections 104 through 106 of PPA '06.

C. *Maintenance of prefunding balance and funding standard carryover balance.*

The proposed regulations would provide that a plan's prefunding balance and funding standard carryover balance as of the beginning of a plan year are adjusted to reflect the actual rate of return on plan assets for the plan year. This calculation of the actual rate of return on plan assets for the plan year is determined on the basis of fair market value and must take into account the amount and timing of all contributions, distributions, and other plan payments made during the year. The adjustment for investment return is applied to the prefunding balance and funding standard carryover balance after any reductions to those balances as described under the following two headings in this preamble. In addition, the proposed regulations would provide special rules in the case of a plan with a valuation date that is not the first day of the plan year.

D. *Use of prefunding balance and funding standard carryover balance to offset minimum funding requirements for a year.*

The proposed regulations would provide that the employer may elect to use some or all of the prefunding balance or funding standard carryover balance to offset the otherwise applicable minimum required contribution for a plan year, provided that the plan met a funding percentage threshold for the preceding plan year. Specifically, an employer is permitted to make such an election only if the plan's prior year funding ratio was at least 80 percent. For this purpose, the plan's prior year funding ratio generally is a fraction (expressed as a percentage), the numerator of which is the value of plan assets on the valuation date for the preceding plan year, reduced by the amount of any prefunding balance (but not the amount of any funding standard carryover balance), and the denominator of which is the funding target of the plan for the preceding plan year (determined without regard to the at-risk rules of section 430(i)(1)).

The proposed regulations would provide a transition rule to determine a plan's prior year funding ratio for the first effective plan year. Under this transition rule, the current liability for the plan for the pre-effective plan year is substituted for the funding target of the plan for that plan year. In addition, the transition rule provides that the value of plan assets is determined under section 412(c)(2) as in effect for that pre-effective plan year, except that the value of plan assets must be limited so that it is not less than 90 percent and not more than 110 percent of the fair market value of plan assets.

The proposed regulations would reflect the rule in section 430(f)(3)(B) that requires the plan sponsor to have reduced the funding standard carryover balance in full (either by using the funding standard carryover balance to offset the minimum required contribution for a year or through a voluntary reduction under section 430(f)(5)) before the prefunding balance is permitted to be used to offset a current year minimum funding requirement.

E. *Subtraction from plan assets and employer election to reduce balances.*

The proposed regulations would reflect the rules under section 430(f)(4) which provide that the prefunding balance and funding standard carryover balance are subtracted from the plan assets for certain purposes. These include the determination of the FTAP, which is also relevant for purposes of applying the benefit limitations of section 436.

In accordance with section 430(f)(4)(A), the proposed regulations would provide that the amount of the prefunding balance is subtracted from the value of plan assets for purposes of determining whether a plan is exempt from the requirement to establish a new shortfall amortization base under section 430(c)(5) only if an election to use the prefunding balance to offset the minimum

required contribution is made for the plan year. In addition, pursuant to section 430(f)(4)(B)(ii), the proposed regulations would provide that the prefunding balance and funding standard carryover balance are not subtracted from plan assets for purposes of determining the funding shortfall under section 430(c)(4) to the extent that there is a binding written agreement with the Pension Benefit Guaranty Corporation (PBGC) which provides that all or a portion of those balances cannot be used to offset the minimum required contribution for a plan year. For this purpose, an agreement with the PBGC is taken into account with respect to a plan year only if the agreement was executed prior to the valuation date for the plan year.

In addition, section 436(j) sets forth an exception from the requirement to subtract the plan's prefunding balance and funding standard carryover balance from the value of plan assets in determining a plan's FTAP for purposes of the benefit limitation rules of section 436 provided that the plan's FTAP would meet certain standards if it were calculated without subtracting the balances from plan assets.

Section 430(f)(5) provides that an employer may elect to reduce the amount of the prefunding balance and the funding standard carryover balance. This will have the effect of increasing the plan assets for various purposes. For example, the increase in plan assets will increase the FTAP, which may allow the plan to avoid the application of section 436 limitations. The proposed regulations would reflect the rule in section 430(f)(5)(B) that requires the employer to reduce the funding standard carryover balance in full (either by using the funding standard carryover balance to offset the minimum required contribution for a year or through a voluntary reduction under section 430(f)(5)) before any reduction is permitted for the prefunding balance.

F. *Elections under section 430(f).*

The proposed regulations would provide that an election under section 430(f) is made by the plan sponsor by providing written notification of the election to the plan's enrolled actuary and the plan administrator, must be irrevocable when made, and must satisfy certain timing rules. The written notification must set forth the relevant details of the election, including the specific amounts involved in the election with respect to the prefunding balance and funding standard carryover balance. An election under section 430(f) generally must be made on or before the due date (with extensions) for the filing of the plan's Form 5500, "*Annual Return/Report of Employee Benefit Plan*", for the plan year to which the election relates (or, in the case of a plan not required to file a Form 5500 for the plan year, on or before the last day of the seventh month after the end of the plan year to which the election relates). For this purpose, an election to add to the prefunding balance relates to the plan year for which excess contributions were made. However, the proposed regulations would require any section 430(f)(5) election to reduce a portion of the prefunding balance or funding standard carryover balance for a plan year to be made by the end of the plan year to which the election relates. For example, in the case of a calendar year plan required to file Form 5500, an election to add to the prefunding balance as of the first day of the 2010 plan year (in an amount not in excess of the 2009 interest-adjusted excess contributions), must be made no later than the due date for filing the 2009 Form 5500 (with extensions), while an election to reduce the prefunding balance as of the first day of the 2010 plan year must be made by the end of the 2010 plan year. In both cases, the election would be reported on the 2010 Form 5500 (Schedule SB) that would be filed in 2011.

The proposed regulations would provide that, for purposes of elections under section 430(f), any reference in the proposed regulations to the plan sponsor generally means the employer or employers responsible for making contributions to the plan. However, in the case of elections under section 430(f) for multiple employer plans to which section 413(c)(4)(A) does not apply, any reference in the proposed regulations to the plan sponsor means the plan administrator within the meaning of section 414(g).

II. *Section 436 — Limits on Benefits and Benefit Accruals Under Single Employer Defined Benefit Plans.*

A. *Overview and general rules.*

1. *In general.*

The proposed regulations would set forth the rules that a defined benefit pension plan that is subject to section 412 and that is not a multiemployer plan must satisfy in order to comply with the requirement in section 401(a)(29) that the plan meet the requirements of section 436. This requirement is a qualification requirement. A plan satisfies the requirements of section 436 only if the plan meets the requirements of these regulations.

2. *New plans.*

In accordance with section 436(g), the proposed regulations would provide that the limitations described in sections 436(b), 436(c), and 436(e) do not apply to a plan for the first five plan years of the plan. For purposes of applying this new plan rule, plan years under a plan are aggregated with plan years under a predecessor plan. Thus, the only benefit limitation that could apply under a plan that is not a successor plan during the first five years of its existence is the section 436(d) limitation applicable to accelerated benefit payments (such as single sum distributions).

3. *Multiple employer plans.*

The proposed regulations under section 436 apply to plans maintained by one employer (including a controlled group of employers) and to multiple employer plans (within the meaning of section 413(c)). In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules under the proposed regulations would be applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, the benefit limitations under section 436 could apply differently to employees of different employers under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to

apply), the proposed regulations under section 436 would apply as if all participants in the plan were employed by a single employer.

4. *Treatment of plan as of close of prohibited or cessation period.*

The proposed regulations would provide that, if a limitation on accelerated benefit payments under section 436(d) (such as single sum distributions) applies to a plan as of a section 436 measurement date, but that limit subsequently ceases to apply to the plan as of a later section 436 measurement date, then the limitation does not apply to benefits with annuity starting dates that are on or after that later section 436 measurement date. In addition, the proposed regulations would provide that, if a limitation on benefit accruals under section 436(e) applies to a plan, unless the plan provides otherwise, benefit accruals under the plan will resume effective as of the section 436 measurement date as of which benefit accruals are no longer restricted.

With respect to a participant who had an annuity starting date within a period during which the accelerated benefit payment limitation rules of section 436(d) applied to the plan, once the limitation ceases to apply, the participant's benefits will continue to be paid in the form previously elected unless the plan permits the participant to be offered a new election which would modify the prior election. The proposed regulations would permit a plan to provide that the participant will be offered the opportunity to have a new election under which the form of benefit previously elected may be modified, subject to applicable qualification requirements, and that new election will constitute a new annuity starting date for purposes of section 417. Similarly, a plan is permitted to be amended to provide that any benefit accruals that were limited under the rules of section 436(e) will be credited under the plan once the limitation no longer applies, subject to applicable qualification requirements. If a plan provides for the restoration of benefit accruals for the period of the limitation under preexisting plan terms, the plan is treated as having adopted an amendment that has the effect of increasing liabilities under the plan if the period of the limitation exceeded 12 months. Whether a plan is amended or is treated as having been amended as described above, the amendment or pre-existing plan provision is subject to the limitations of section 436(c).[3]

In addition, the proposed regulations would provide that a plan is permitted to be amended to provide that any unpredictable contingent event benefits that were limited under the rules of section 436(b) will be paid or reinstated when the limitation no longer applies, subject to applicable qualification requirements. Any such amendment is subject to the limitations of section 436(c). A plan is not permitted to provide for restoration of any such unpredictable contingent event benefits without an amendment that complies with section 436(c).

5. *Deemed election to reduce prefunding and funding standard carryover balances.*

The proposed regulations would provide that, if a limitation on accelerated benefit payments under section 436(d) would otherwise apply to a plan, the plan sponsor is treated as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the AFTAP to be at or above the applicable threshold (60, 80, or 100 percent, as the case may be) in order for the benefit limitation not to apply to the plan. In such a case, the plan sponsor is treated as having made that election on the section 436 measurement date as of which the benefit limitation would otherwise apply. This deemed election applies if the plan provides for accelerated distributions that would be limited in a plan year, regardless of whether a plan participant is eligible or elects to receive such a distribution during the plan year (but does not apply if the plan does not provide for any accelerated distributions that are subject to the benefit limitation). However, the deemed reduction applies with respect to this limitation only if the prefunding and funding standard carryover balances to be reduced are large enough to avoid the application of the limitation. Thus, no reduction of prefunding and funding standard carryover balances is required if the limitation would still apply for a year even if those balances were reduced to zero.

In addition, the proposed regulations would provide that, in the case of a plan maintained pursuant to one or more collective bargaining agreements between an employee representative and one or more employers in which a benefit limitation under section 436(b), 436(c), or 436(e) would otherwise apply to the plan, the employer is treated for purposes of section 436 as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the AFTAP to be at or above the applicable threshold for the benefit limitation not to apply to the plan, taking into account the unpredictable contingent event benefits or plan amendment, as applicable. The proposed regulations would provide that, in the case of a plan with respect to which collective bargaining agreements apply to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of this provision if at least 25 percent of the participants in the plan are members of the collective bargaining units for whom the benefit levels under the plan are specified under the collective bargaining agreements. As in the case of the deemed reduction in funding balances for the accelerated benefit distributions under section 436(d), the deemed reduction applies only if the prefunding and funding standard carryover balances to be reduced are large enough to avoid the application of the limitation under section 436(b), 436(c), or 436(e), as applicable.

If the mandatory reduction of funding balances applies to a plan, the employer is treated as having made that election on the date as of which the applicable benefit restriction would otherwise apply. In addition, the proposed regulations would provide that, if a plan (whether or not collectively bargained) is presumed to have an AFTAP of less than 60 percent under the section 436(h) presumption rules, then the plan is treated as if the plan's funding standard carryover balance and prefunding balance are insufficient to increase the plan's AFTAP to the threshold percentage.

[3] The PBGC has informed the IRS and the Treasury Department that it expects similarly to treat such an automatic restoration of missed benefit accruals as a plan amendment.

6. *Section 436 measurement date.*

The "section 2007 436 measurement date" is a defined term under the proposed regulations that is used to describe the date that stops or starts the application of the limitations of sections 436(d) and 436(e) and is also used for calculations with respect to applying the limitations of sections 436(b) and 436(c). The regulations would provide that the date of the enrolled actuary's certification of the AFTAP for the plan year is a section 436 measurement date if it occurs within the first nine months of the plan year. If the date of an enrolled actuary's certification of the AFTAP is between the first day of the 10th month of a plan year and the last day of that plan year, that date is not a section 436 measurement date for purposes of the limitations of section 436(d) or 436(e) because, in that case, the plan's AFTAP is presumed to be under 60 percent (however, receipt of the enrolled actuary's certification during that period impacts the plan's presumed "carryover" AFTAP for the following year). The proposed regulations would provide that a section 436 measurement date occurs where there is a change in the plan's AFTAP under the presumption rules of section 436(h). In addition, the proposed regulations would provide a series of rules in cases where the enrolled actuary's certification of the AFTAP for a plan year is made after the end of the plan year, as described below under the heading "Presumed underfunding for purposes of benefit limitations."

B. *Limitation on plant shutdown and other unpredictable contingent event benefits.*

In accordance with section 436(b), the proposed regulations would provide that a plan that provides for any unpredictable contingent event benefit[4] must provide that the benefit will not be paid to a plan participant during a plan year if the AFTAP for the plan year is less than 60 percent (or is 60 percent or more but would be less than 60 percent if the benefits attributable to the unpredictable contingent event were taken into account in determining the AFTAP). However, this prohibition on payment of unpredictable contingent event benefits no longer applies for a plan year, effective as of the first day of the plan year, if the employer makes the contribution specified in section 436(b)(2), as described in paragraph II.F in this preamble.

For this purpose, the proposed regulations would provide that an "unpredictable contingent event benefit" means any benefit or increase in benefits to the extent the benefit or increase would not be payable but for the occurrence of an unpredictable contingent event, and an "unpredictable contingent event" means a plant shutdown (whether full or partial) or similar event, or an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability. Thus, for example, if a plan provides for an unreduced early retirement benefit upon the occurrence of an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability, then that unreduced early retirement benefit is an unpredictable contingent event benefit to the extent of any portion of the benefit that would not be payable but for the occurrence of the event, even if the remainder of the benefit is payable without regard to the occurrence of the event. Similarly, an unpredictable contingent event benefit under the proposed regulations includes a benefit payable upon the presence of circumstances specified in the plan (other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability), so that a plan that provides those benefits upon a participant's severance from employment in those circumstances, but not upon a severance from employment that does not involve those circumstances, is providing an unpredictable contingent event benefit.

Unpredictable contingent event benefits attributable to a plant shutdown or other unpredictable contingent event that occurred within a period during which no limitation under section 436(b) applied to the plan are not affected by the limitation as it applies in a subsequent period. For example, if a plant shutdown occurs in 2010 and a plan's funded status is such that its shutdown benefits are not subject to the limitation for that plan year, benefits paid pursuant to that shutdown are permitted to be paid in a later plan year even if the plan's AFTAP for the subsequent year is less than 60 percent. Conversely, if a plant shutdown occurs in 2010 and a plan's funded status is such that its shutdown benefits are subject to the limitation under section 436(b) for that plan year and cannot be paid, those shutdown benefits related to the 2010 plant shutdown are not permitted to be paid in a later year even if the plan's AFTAP for the later year is at or above the 60 percent threshold for the section 436(b) limitation (subject to the rules permitting plan amendments to reinstate previously restricted benefits, including unpredictable contingent event benefits, as described in paragraph II.A.4 of this preamble).

C. *Limitations on plan amendments increasing liability for benefits.*

In accordance with section 436(c), the proposed regulations would provide that a plan satisfies the limitation on plan amendments increasing liability for benefits only if the plan provides that no amendment to the plan that has the effect of increasing liabilities of the plan by reason of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become nonforfeitable is permitted to take effect if the AFTAP for the plan year is less than 80 percent (or is 80 percent or more but would be less than 80 percent if the benefits attributable to the amendment were taken into account in determining the AFTAP). However, this prohibition on plan amendments no longer applies for a plan year if the employer makes the contribution specified in section 436(c)(2), as described in paragraph II.F of this preamble.

In accordance with section 436(c)(3), the limitation on amendments increasing liabilities does not apply to any amendment that provides for an increase in benefits under a formula that is not based on a participant's compensation, but only if the rate of increase in benefits does not exceed the contemporaneous rate of increase in average wages of participants covered

[4] See also Notice 2007–14, 2007–7 I.R.B. 501 (see §601.601(d)(2) of this chapter), requesting comments on the types of benefits that are permitted to be provided in a qualified defined benefit plan, including benefits payable in the event of a plant shutdown or similar event.

by the amendment. The proposed regulations would provide that the determination of the rate of increase in average wages is made by taking into consideration the net increase in average wages during the period beginning with the effective date of the most recent benefit increase applicable to all of those participants who are covered by the current amendment and ending on the effective date of the current amendment. If the participants covered by an amendment include both currently employed participants and terminated participants (who will have no increase or decrease in wages for this purpose after severance from employment), all covered participants must be included in determining the increase in average wages of the participants covered by the amendment. Alternatively, the employer could adopt two amendments — one that increases benefits for currently employed participants and another one that increases benefits for the terminated participants. In that case, this exception from application of the section 436(c) limitation generally would apply to the amendment that increases benefits for currently employed participants (based solely on the wages of those current employees), but the amendment that applies only to terminated participants (who received no increase in wages from the employer during the period over which the increase in average wages is determined) would not be eligible for the exception.

In addition, the proposed regulations would provide that, to the extent that any amendment results in (or is made pursuant to) a mandatory increase in the vesting of benefits under the Code or ERISA (such as vesting rate increases pursuant to statute and plan termination amendments under section 411(d)(3)), that amendment does not constitute an amendment that changes the rate at which benefits become nonforfeitable for purposes of section 436(c).

D. *Limitations on accelerated benefit distributions.*

1. *Funding percentage less than 60 percent.*

In accordance with section 436(d)(1), under the proposed regulations, a plan must provide that, if the plan's AFTAP for a plan year is less than 60 percent, the plan will not pay any prohibited payment with an annuity starting date that is on or after the applicable section 436 measurement date. However, if a participant requests such a prohibited distribution, the plan must permit the participant to elect another form of benefit available under the plan or to defer payment to a later date to the extent permitted under applicable qualification requirements. Similar rules apply in any case in which a beneficiary is entitled to a prohibited payment (for example, where a qualified pre-retirement survivor annuity is offered in an alternative single sum payment).

2. *Bankruptcy.*

In accordance with section 436(d)(2), under the proposed regulations, a plan must provide that the plan will not pay any prohibited payment with an annuity starting date that is during any period during a plan year in which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, until the date on which the enrolled actuary of the plan certifies that the plan's AFTAP is not less than 100 percent.

3. *Limited payment if percentage at least 60 percent but less than 80 percent.*

In accordance with section 436(d)(3), under the proposed regulations, a plan must provide that, in any case in which the plan's AFTAP for a plan year is 60 percent or more but is less than 80 percent, a participant is permitted to elect a prohibited payment only if the present value of the portion of the payment that is greater than the amount of the monthly straight life annuity under the plan (and any social security supplement, if applicable) does not exceed 50 percent of the present value of the participant's benefits (or if less, 100 percent of the present value of the maximum guarantee with respect to the participant under section 4022 of ERISA). For this purpose, present value is determined using the rules of section 417(e) except that, if the plan provides a single sum distribution that is larger than the present value of the benefit determined using the rules of section 417(e), then that larger benefit is substituted for the present value of the participant's benefits before applying the 50 percent factor. Similar rules apply in any case in which a beneficiary is entitled to a prohibited payment.

If an optional form of benefit that is otherwise available under the terms of the plan is not available as of the annuity starting date because it is a prohibited payment that cannot be paid under the preceding paragraph, then the plan must provide a participant who elects such an optional form with the option either to defer payment to a later date (to the extent permitted under applicable qualification requirements) or to bifurcate the benefit into unrestricted and restricted portions. If the participant elects to bifurcate the benefit, the plan must permit the participant to elect, with respect to the unrestricted portion, any optional form of benefit otherwise available under the plan with respect to the participant's entire benefit (whether or not the optional form of benefit with respect to the unrestricted portion is a prohibited payment). The unrestricted portion of the benefit is the lesser of (i) 50 percent of the benefit and (ii) the benefit that has a present value that does not exceed 100 percent of the present value of the maximum PBGC guarantee with respect to the participant under section 4022 of ERISA. If the participant elects payment of the unrestricted portion of the benefit in the form of a prohibited payment, then the plan must permit the participant to elect payment of the restricted portion in any optional form of benefit under the plan that would have been permitted with respect to the participant's entire benefit other than a prohibited payment. A plan is also permitted (but not required) to offer optional forms of benefit that are solely available during the period section 436(d)(3) applies to the plan, such as an optional form of benefit that provides for the current payment of the unrestricted portion of the benefit, with a delayed commencement for the restricted portion of the benefit, subject to other applicable qualification requirements.

A participant who receives a prohibited payment (or a series of prohibited payments under a single optional form of benefit) under the rule permitting certain prohibited payments cannot receive any additional payment that would be a prohibited payment until there is a plan year for which none of the limitations on accelerated distributions under section 436(d) apply. Benefits provided to a participant and any beneficiary are aggregated for purposes of determining the limited distribution under section 436(d)(3). The pro-

posed regulations would also reflect the rules of section 436(d)(3)(B)(ii), which describes how this limited distribution is allocated among the beneficiaries of a participant.

4. *Exception for certain frozen plans.*

In accordance with section 436(d)(4), the limitations under section 436(d) will not apply to a plan for any plan year if the terms of the plan, as in effect for the period beginning on September 1, 2005, provided for no benefit accruals with respect to any participants. However, if such a plan provides for any benefit accruals during a plan year, this exception will cease to apply for the plan as of the date those accruals start.

5. *Prohibited payment.*

In accordance with section 436(d)(5), the proposed regulations would provide that the term "prohibited payment" means:

(i) Any payment for a month that is in excess of the monthly amount paid under a single life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)), to a participant or beneficiary whose annuity starting date (as defined in section 417(f)(2)) occurs during any period that a limitation on accelerated benefit payments is in effect;

(ii) Any payment for the purchase of an irrevocable commitment from an insurer to pay benefits; and

(iii) Any other payment that is identified as a prohibited payment by the Commissioner in revenue rulings and procedures, notices and other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

In addition, for purposes of applying the limitations on accelerated benefit payments under the requirements of section 436(d), the term *annuity starting date* means, as applicable—

(a) The first day of the first period for which an amount is payable as an annuity as described in section 417(f)(2)(A)(i);

(b) In the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred (including the participant's election, the participant's severance from employment if the participant is below normal retirement age, and, if applicable, the participant's survival to the date as of which payment is made) which entitle the participant to such benefit as described in section 417(f)(2)(A)(ii);

(c) In the case of an amount payable under a retroactive annuity starting date, the benefit commencement date; and

(d) The date of any payment for the purchase of an irrevocable commitment from an insurer to pay benefits under the plan.

E. *Limitation on benefit accruals.*

In accordance with section 436(e), under the proposed regulations, a plan must provide that, in any case in which the plan's AFTAP for a plan year is less than 60 percent, benefit accruals under the plan will cease as of the applicable section 436 measurement date. If a plan must cease benefit accruals under this limitation, then the plan is also not permitted to be amended in a manner that would increase the liabilities of the plan by reason of an increase in benefits or establishment of new benefits. This rule applies regardless of whether an amendment would otherwise be permissible under section 436(c)(3) (involving certain amendments to increase benefits under a formula not based on a participant's compensation). This prohibition on additional benefit accruals will no longer apply for a plan year if the plan sponsor makes the contribution specified in section 436(e)(2), as described in paragraph II.F of this preamble.

F. *Rules relating to contributions required to avoid benefit limitations.*

The proposed regulations provide rules regarding contributions by the plan sponsor to avoid benefit limitations under section 436. An employer sponsoring a plan that would otherwise be subject to the limitations of section 436 can avoid the application of those limits through one of four different techniques: 1) reducing the funding standard carryover balance and prefunding balance; 2) making additional contributions for a prior plan year that are not added to the prefunding balance; 3) making the specific contributions described in sections 436(b)(2), 436(c)(2), and 436(e)(2); and 4) providing security, as described in section 436(f)(1).

As noted in this preamble, under the first of the techniques, if a plan sponsor elects to reduce the plan's funding standard carryover balance or the prefunding balance, this will have the effect of increasing the plan assets that are taken into account in determining the plan's FTAP and AFTAP and, thereby, will raise the AFTAP to a level so that the benefit limitations may no longer apply to the plan. Alternatively, if the deadline for making prior year contributions has not passed, the plan sponsor could utilize the second technique — making additional contributions for the prior plan year. If these additional contributions are not added to the prefunding balance, then the additional contributions will also have the effect of increasing the plan's FTAP and AFTAP.

The third and fourth techniques for avoiding the application of the benefit limitations of section 436 are described in §1.436–1(f) of the proposed regulations. Under the third technique, the plan sponsor makes additional contributions that are specifically designated at the time the contribution is used to avoid the application of a limitation under section 436(b), 436(c), or 436(e). The proposed regulations would provide for this designation to be provided to the plan's enrolled actuary and plan administrator in writing. Furthermore, the designation must be irrevocable, except as described below. If the contributions are made on a date other than the valuation date for the plan year, the contributions must be adjusted for interest (using the plan's effective interest rate, except as provided in the proposed regulations). These contributions are separate from any minimum required contributions required by section 430, and no prefunding balance or funding standard carryover balance under section 430(f) may be used as a contribution to avoid a section 436 benefit limitation. A plan sponsor that makes such a current year contribution will nonetheless fail to satisfy the minimum funding requirements if it does not make the minimum required contribution under section 430 for the year. In addition, as noted above, these contributions are not taken into account in determining whether a plan sponsor is making excess contributions for purposes of adding to the plan's prefunding balance.

The fourth technique for a plan sponsor to avoid the application of the benefit limitations of section 436 is for the plan sponsor to provide security. In such a case, the AFTAP for the plan year is determined by treating as an asset of the plan any security

provided by a plan sponsor by the valuation date for the plan year in a form meeting certain specified requirements. However, this security is not taken into account for any other purpose, including section 430. The only security permitted to be provided by a plan sponsor for this purpose is (i) a bond issued by a corporate surety company that is an acceptable surety for purposes of section 412 of ERISA, or (ii) cash or United States obligations that mature in three years or less that are held in escrow by a bank or insurance company. The regulations would reflect sections 436(f)(1)(C) and (D) in specifying when the security is to be contributed to the plan and when it may be released. If the security is turned over to the plan, then that amount is treated as an employer contribution when it is turned over to the plan. The proposed regulations would provide that any such security turned over to the plan pursuant to the enforcement mechanism cannot be treated as a contribution to avoid or terminate the application of a section 436 benefit limitation under section 436(b)(2), 436(c)(2), or 436(e)(2).

G. *Presumed underfunding for purposes of benefit limitations.*

The proposed regulations reflect the rules of section 436(h), which sets forth a series of presumptions that are used to apply the section 436 benefit limitations in situations where the plan's enrolled actuary has not yet issued a certification of the plan's AFTAP for the plan year. In addition, the proposed regulations also set forth rules for the application of the limitations prior to and during the period those presumptions apply to a plan, and describe the interaction of those presumptions with plan operations after the plan's enrolled actuary has issued a certification of the plan's AFTAP for the plan year. These rules are designed to encourage plans to obtain certifications in a timely manner, with a particular emphasis with respect to plans that have a greater likelihood of having a new section 436 benefit limitation apply because they had an AFTAP for the prior plan year that was near a threshold for a benefit limitation to apply.

The proposed regulations would provide that, in any case in which a plan was subject to a benefit limitation on the last day of the prior plan year, the first day of the plan year is a section 436 measurement date and the AFTAP of the plan for the current plan year is presumed to be equal to the preceding year's certified AFTAP until the plan's enrolled actuary certifies the AFTAP of the plan for the current plan year. Because no plan could be subject to a benefit limitation for a plan year that precedes the plan year that begins in 2008, the section 436(h)(1) presumption generally will not apply to any plan before the first plan year beginning in 2009.

In accordance with section 436(h)(3), the proposed regulations would provide that, if the enrolled actuary of the plan has not certified the AFTAP of the plan for the current plan year by the first day of the 4th month of the plan year and the AFTAP for the preceding year was certified to be at least 60 percent but less than 70 percent or at least 80 percent but less than 90 percent (or, if that preceding year is the pre-effective plan year, was certified to be less than 90 percent), then the first day of the 4th month of the current plan year is a section 436 measurement date, and the AFTAP of the plan is presumed to be equal to 10 percentage points less than the AFTAP of the plan for the preceding plan year. This presumption will apply until the earlier of the date the enrolled actuary certifies the AFTAP for the plan year or the first day of the 10th month of the plan year.

In accordance with section 436(h)(2), the proposed regulations would provide that, in any case in which no certification of the specific AFTAP for the current plan year is made before the first day of the 10th month of such year, that date is a section 436 measurement date and, as of that date, the plan's AFTAP is conclusively presumed to be less than 60 percent. In such a case, the presumed AFTAP of under 60 percent for the current plan year will continue to apply under the rules of section 436(h)(1) for the next plan year, until such time as the enrolled actuary certifies the AFTAP for either the current plan year or the next plan year.

The proposed regulations would provide rules that apply the section 436(h) presumptions for the plan year in cases in which the enrolled actuary's certification for the prior plan year is made on or after the first day of the 10th month of that prior plan year. If the date of the enrolled actuary's certification of the specific AFTAP for a plan year occurs on or after the date the conclusive presumption applies but on or before the last day of the plan year, the proposed regulations would provide that the certified percentage is disregarded for that plan year but is used for purposes of the presumption rule of section 436(h)(1) starting with the beginning of the following plan year (rather than continuing to apply the less-than-60 percent presumption that applied before the first day of that following plan year). If the date of the enrolled actuary's certification of the specific AFTAP for a plan year occurs after the end of the plan year but prior to the first day of the 4th month in the following plan year, the proposed regulations would provide that the certification date is treated as a section 436 measurement date for that following plan year and that, starting on that date, the plan's AFTAP is presumed to be the certified AFTAP for the prior year (rather than continuing to apply the less-than-60 percent presumption that applied before the certification). If the date of the enrolled actuary's certification of the specific AFTAP for a plan year occurs after the first day of the 4th month in the following plan year but before the first day of the 10th month, the proposed regulations would provide that the certification date also is a section 436 measurement date for that following plan year, and the plan's AFTAP for that following year beginning on that date is presumed to be the certified AFTAP for the prior year (rather than continuing to apply the less-than-60 percent presumption that applied before the certification). However, in such a case, if a 10 percentage point reduction in the AFTAP would have applied on the first day of the 4th month of that following plan year if the AFTAP for the prior plan year had been certified before that day, then the same 10 percentage point reduction applies on the date of the certification. These presumption rules based on the prior year AFTAP do not apply once a certification of the following year's AFTAP is issued by the plan's enrolled actuary.

The enrolled actuary's certification of the AFTAP for a plan year must be made in writing, must be provided to the plan administrator, and must certify the plan's AFTAP for the plan year. As an alternative to certifying a specific number for the plan's AFTAP, the regulations would provide that the enrolled actuary is permitted

to certify during the first nine months of a plan year that the plan's AFTAP for that year is within a percentage "range" that is either (i) 60 percent or higher, but less than 80 percent, (ii) 80 percent or higher, or (iii) 100 percent or higher. The proposed regulations would provide that such a "range" certification ends the application of the presumptions provided that the enrolled actuary follows up with a certification of the specific AFTAP before the first day of the 10th month of that year and that the certified specific AFTAP is within the range of the earlier certification.

If this "range" certification alternative is followed, the plan is treated as having a certified AFTAP at the smallest value within the applicable range. Thus, for example, if the enrolled actuary certified that the AFTAP was more than 60 percent but less than 80 percent, then the plan is treated as having an AFTAP of 60 percent for purposes of applying the limitations of section 436(b) until the earlier of the date of the specific AFTAP certification or the first day of the 10th month of the plan year. In such a case, if the plan has an unpredictable contingent event or a plan amendment that increases liability for benefits, unpredictable contingent event benefits cannot be paid and the plan amendment cannot take effect unless the plan sponsor makes a contribution described in section 436(b)(2) or 436(c)(2), as applicable. If the plan sponsor makes a contribution under section 436(b)(2) or section 436(c)(2), the proposed regulations would provide that the contribution is recharacterized as a regular employer contribution that is taken into account under section 430 for the current plan year to the extent it is determined that the contribution was not needed to avoid the application of the benefit limit, based on the subsequent calculation of the specific AFTAP.

The proposed regulations would specify that the enrolled actuary is generally not permitted to certify the AFTAP based on a value of assets that includes contributions receivable for the prior year that have not actually been made as of the date of the certification. However, this rule would not apply to certifications that are made for plan years beginning before January 1, 2009. Thus, for a certification with respect to 2008, the enrolled actuary is permitted to take in account contributions for 2007 that are reasonably expected but have not yet been made by the plan sponsor at the time of the certification. However, if the plan sponsor does not make those contributions, the enrolled actuary's certification will be incorrect, which will result in a failure to satisfy section 401(a)(29) and section 436 if the difference constitutes a material change.

If the enrolled actuary for the plan provides a certification of the AFTAP for the plan year (including a range certification) and that certified percentage is superseded by a subsequent determination of the AFTAP for that plan year, that later percentage must be applied and a determination must be made whether the change in the applicable percentage is a material change or an immaterial change. For this purpose, the proposed regulations would specify that there is a material change if plan operations with respect to benefits that are addressed by section 436, taking into account any actual contributions and elections under section 430(f) made by the plan sponsor based on the prior certified percentage, would have been different based on the subsequent determination of the plan's AFTAP for the plan year. Thus, for example, if after the actuary certifies the plan's AFTAP for a plan year, the plan sponsor elects to add excess contributions for the prior plan year to the plan's prefunding balance, this would have the effect of reducing the plan's AFTAP, and such a change could be a material change.

The proposed regulations would specify that an immaterial change is a change in an AFTAP that is not a material change. In addition, the proposed regulations would provide that if the difference between the AFTAP for a plan year and the later revised determination of that percentage is the result of additional contributions for the preceding year that are made by the plan sponsor after the date of the enrolled actuary's certification or results from the plan sponsor's election to reduce the prefunding or funding standard carryover balance after the date of the certification, such change is always treated as an immaterial change (regardless of whether it would otherwise affect the application of the section 436 benefit limitations).

In the case of a material change where the plan was operated in accordance with the prior certification of the AFTAP for the plan year, the plan will not have satisfied the requirements of section 401(a)(29) and section 436. In the case of a material change where the plan was operated in accordance with the subsequent certification of the AFTAP during the period of time the prior certification applied, the plan will not have been operated in accordance with its terms. In addition, in the case of a material change, the rules requiring application of a presumed AFTAP under section 436(h) continue to apply from and after the date of the prior certification until the date of the subsequent certification. In the case of an immaterial change, the revised percentage applies prospectively but it does not change the inapplicability of the presumptions under section 436(h) for the plan year prior to the date of the subsequent certification.

H. *Coordination between presumptions and determination of AFTAP.*

1. *Periods during which a presumption applies to the plan.*

A plan must provide that, for any period during which a presumption under section 436(h) applies to the plan, the limitations applicable under sections 436(b), 436(c), 436(d), and 436(e) apply to the plan as if the actual AFTAP for the year were the presumed AFTAP. During that period, the rules relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance must be applied based on the presumed percentage with respect to the applicable limitations. Thus, a plan's prefunding balance and funding standard carryover balance must be reduced if the reduction would be sufficient to avoid the applicable limitation. The proposed regulations provide rules for determining the amount of the reduction in balances.

If the presumed AFTAP for the plan year changes during the year because of application of the presumption in section 436(h)(3), the rules regarding the deemed election to reduce funding balances must be reapplied based on the new presumed AFTAP. This reapplication of the deemed election may require an additional reduction in funding balances if the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of the limitation under section 436(d) or 436(e) is greater than the amount that was initially reduced.

2. *Periods prior to certification where no presumption applies.*

If no presumptions under section 436(h) apply to a plan for a period and the plan's enrolled actuary has not yet issued the certification of the plan's AFTAP for the plan year, the plan is not permitted to limit the payment of unpredictable contingent event benefits or the accrual of benefits based on an expectation that the limitations under section 436(d) or 436(e) will apply to the plan once the enrolled actuary's certification of the AFTAP is issued. In addition, the proposed regulations would provide that, if no presumptions under section 436(h) apply to a plan during a period and the plan's enrolled actuary has not yet issued a certification of the plan's AFTAP for the plan year, the limitations under sections 436(b) and 436(c) that apply to unpredictable contingent event benefits and certain plan amendments, respectively, during that period must be applied following the special rules described below in paragraph H.3. of this preamble. Thus, if after application of those rules the plan would be treated as having an AFTAP below the applicable threshold under section 436(b) or 436(c), the limitation will apply unless the plan sponsor makes a contribution to avoid application of the applicable benefit limitations described in section 436(b)(2) or 436(c)(2). In such case, following the certification of the AFTAP for the current plan year by the plan's enrolled actuary, the proposed regulations would provide that those contributions are recharacterized as employer contributions under section 430 for the current plan year to the extent they exceed the amount necessary to avoid application of the applicable limitation under section 436(b) or 436(c) based on the certified percentage.

3. *Periods prior to certification — special rules for unpredictable contingent event benefits and plan amendments that increase liability.*

The proposed regulations would provide that, during the pre-certification period, the rules relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance must be applied based on the plan's presumed AFTAP. The proposed regulations would provide rules for determining the amount of the reduction in those balances that would apply in such a situation and provide that, in making such determination, the presumed adjusted funding target is increased to take into account the benefits attributable to the unpredictable contingent event or the plan amendment described in section 436(b) and 436(c), respectively. For this purpose, if no presumption applies under the rules of section 436(h) (for example, because the plan's actual AFTAP for the prior year was certified to be at least 80 percent), then that prior year's actual AFTAP is substituted for the presumed AFTAP for the plan year in determining the presumed adjusted funding target. In the case of a plan that is not a collectively bargained plan with a funding standard carryover balance or a prefunding balance, the deemed election rules do not apply for purposes of sections 436(b) and 436(c), and the plan sponsor is permitted (but not required) to reduce those balances in order to increase the adjusted plan assets that are compared to the presumed AFTAP.

If, after application of such funding balance reductions and the other calculations set forth in the proposed regulations, the plan's AFTAP (taking into account the additional benefits) is less than the applicable threshold under section 436(b) or 436(c), as applicable, then the plan is not permitted to provide any benefits attributable to the unpredictable contingent event or plan amendment unless the plan sponsor makes a contribution that would allow payment of unpredictable contingent event benefits or would permit a plan amendment increasing benefit liabilities to go into effect under the rules of section 436(b)(2) or 436(c)(2).

If, after application of such funding balance reductions, the plan's AFTAP (taking into account the additional benefits) is greater than or equal to the applicable threshold under section 436(b) or 436(c), as applicable, then the plan is not permitted to limit the payment of unpredictable contingent event benefits under section 436(b) or to restrict a plan amendment increasing liability for benefits from taking effect under section 436(c) based on an expectation that those limitations will apply to the plan once the enrolled actuary's certification is issued.

4. *Limitations based on AFTAP.*

The proposed regulations would provide that, on and after the date the enrolled actuary for the plan issues a certification of the AFTAP for the current plan year, the plan must apply that certified percentage (however, if the certification is issued on or after the first day of the 10th month of the current plan year but before the first day of the following plan year, the certified percentage applies under the presumption rules beginning on the first day of that following plan year). For example, the plan sponsor must apply the certified AFTAP for a plan year to an unpredictable contingent event that occurs or a plan amendment that is effective on or after the date of the enrolled actuary's certification during the plan year. Thus, the plan administrator must determine if the AFTAP is at or above the applicable threshold, taking into account the increase in the funding target that would be attributable to the unpredictable contingent event or plan amendment if the unpredictable contingent event benefits or the increase in liability attributable to the plan amendment were taken into account.

After the AFTAP for a plan year is certified by the plan's enrolled actuary, with respect to the application of limitations under sections 436(d) and 436(e) (accelerated benefit payments and benefit accruals, respectively) for the plan year, the deemed election to reduce funding balances must be reapplied based on the actual funding target for the year (provided the certification is issued by the first day of the 10th month). This reapplication of the deemed election may require an additional reduction in funding balances if the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of those limitations is greater than the amount of a prior reduction for the plan year. The proposed regulations would also reflect section 436(d)(2), which provides that no prohibited payments under section 436(d)(5) are permitted to be paid by a plan during any period in which the plan sponsor is a debtor in a case under title 11, United States Code, or any similar Federal or State law, if the plan's enrolled actuary has not yet certified the plan's AFTAP for the plan year to be at least 100 percent. Thus, the

presumptions do not apply for purposes of section 436(d)(2).

The proposed regulations would provide that the enrolled actuary's certification of the AFTAP does not affect the application of the limitation under section 436(d) for participants with annuity starting dates before the certification. Similarly, the enrolled actuary's certification for the plan year does not affect the application of the limitation under section 436(e) of this section prior to the date of that certification.

With respect to the impact of the enrolled actuary's certification of the AFTAP for a plan year on periods prior to the certification, the proposed regulations would provide that the certification does not affect the application of limitations under sections 436(b) and 436(c) for periods prior to the date the certification is issued, regardless of the extent to which the certified percentage varies from the presumed percentage. Notwithstanding the foregoing, in the case of a plan that, for a plan year, did not provide benefits attributable to an unpredictable contingent event or plan amendment based on the preceding year's certified AFTAP (and where sufficient contributions under section 436(b)(2) or 436(c)(2) were not made), the plan must provide any benefits that were not so provided if those benefits would be permitted under the rules of section 436 based on the certified AFTAP, taking into account the increase in the funding target that would be attributable to the unpredictable contingent event benefits or increase in liability due to the plan amendment.

A special rule applies if a plan is providing benefits with respect to one or more unpredictable contingent events occurring within the plan year or amendments taking effect within the plan year. In such a case, the restrictions on unpredictable contingent event benefits and plan amendments are applied with respect to a subsequent unpredictable contingent event or amendment by treating the increase in the funding target attributable to the subsequent event or amendment as if it included the increases in the funding target attributable to all such earlier events or amendments.

I. *Determination of funding target attainment percentage.*

For purposes of section 436, the *funding target* means the funding target under section 430(d) or section 430(i), as applicable to the plan for a plan year.

For purposes of section 436, the *funding target attainment percentage* (FTAP) for any plan year is the fraction (expressed as a percentage), the numerator of which is the value of net plan assets, and the denominator of which is the plan's funding target (determined without regard to the at-risk rules under section 430(i) even in the case of a plan that is in at-risk status). For this purpose, pursuant to section 430(f)(4), the value of net plan assets for the plan year is generally determined by subtracting the plan's funding standard carryover balance and prefunding balance (if any) for the plan year from the value of plan assets.

The *adjusted funding target attainment percentage* (AFTAP) for any plan year is the fraction (expressed as a percentage), the numerator of which is the adjusted plan assets and the denominator of which is the adjusted funding target. The adjusted plan assets equals the net plan assets, increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years. The proposed regulations would provide that the adjusted funding target equals the funding target for the plan year (determined without regard to the at-risk rules under section 430(i)), increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years.

If the FTAP for a plan year, determined without regard to the section 430(f)(4) subtraction of the funding standard carryover balance and the prefunding balance from the value of plan assets, would be 100 percent or more, then, for purposes of section 436 (but not section 430(d)), the value of net plan assets used in the determination of the FTAP and the AFTAP is determined without regard to any subtraction of funding balances under section 430(f)(4). The proposed regulations would reflect the transition rule of section 436(j)(3)(B) under which a plan is permitted to phase up to 100 percent for purposes of the preceding sentence.

The proposed regulations would also provide that, in the case of the first plan year beginning in 2008, the FTAP for the preceding plan year is determined as a fraction (expressed as a percentage), the numerator of which is the value of net plan assets, and the denominator of which is the plan's current liability determined pursuant to section 412(l)(7) on the valuation date for the last plan year that begins before 2008 (the 2007 plan year). For this purpose, the value of plan assets is determined under section 412(c)(2) as in effect for the 2007 plan year, except that the value of plan assets prior to subtraction of the plan's funding standard account credit balance described below can neither be less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for that plan year. If a plan has a funding standard account credit balance as of the valuation date for the 2007 plan year, that balance must be subtracted from the asset value described above as of that date unless the value of plan assets is greater than or equal to 90 percent of the plan's current liability determined under section 412(l)(7) on the valuation date for the 2007 plan year.

In the case of the first plan year beginning in 2008, for purposes of determining the AFTAP for the 2007 plan year, the proposed regulations provide that the adjusted funding target is equal to the current liability determined pursuant to section 412(l)(7) on the valuation date for the 2007 plan year, increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years. In any case in which the plan's enrolled actuary has not issued a certification of the AFTAP of the plan for the 2007 plan year using this rule, the AFTAP of the plan for the first plan year beginning in 2008 is presumed to be less than 60 percent until the AFTAP of the plan for the 2007 plan year has been certified or the AFTAP of the plan for the first plan year beginning in 2008 has been certified. This rule applies for purposes of sections 436(b) and 436(c) at the beginning of the first plan year beginning in 2008 and applies for purposes of sections 436(d) and

436(e) as of the first day of the 4th month of the first plan year beginning in 2008. The special rules permitting range certifications for plan years beginning after 2007 do not apply to the 2007 plan year.

However, if the employer makes an election to reduce some or all of the funding standard carryover balance as of the first day of the first plan year beginning in 2008 in accordance with proposed §1.430(f)–1(e), then the present value (determined as of the valuation date for the prior year using the valuation interest rate for that prior year) of the amount so reduced is not treated as part of the funding standard account credit balance when that balance is subtracted from the value of net plan assets. Thus, an employer's election to reduce the funding standard carryover balance in 2008 will have the effect of reducing the amount that must be subtracted from the assets in determining the 2007 AFTAP for purposes of applying the presumptions under section 436(h)(3) as of the first day of the 4th month of the plan year beginning in 2008.

Proposed Legislation

As of the date of issuance of these proposed regulations, bills have been introduced in the House of Representatives and the Senate that would exclude mandatory cash-out distributions under section 411(a)(11) from application of the accelerated payments limitation under section 436(d) and that would provide the Treasury Department with authority to address application of the presumptions under section 436(h) to plans that have valuation dates that are later than the first day of the plan year.[5] Proposed §1.436–1(d)(6) and §1.436–1(h)(5), respectively, are reserved in order to accommodate such changes.

Section 1107 of PPA '06 and Code Section 411(d)(6)

Under section 1107 of PPA '06, a plan sponsor is permitted to delay adopting a plan amendment pursuant to statutory provisions under PPA '06 (or pursuant to any regulation issued under PPA '06) until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 in the case of governmental plans). As described in Rev. Proc. 2007–44, 2007–28 I.R.B. 54, this amendment deadline applies to both interim and discretionary amendments that are made pursuant to PPA '06 statutory provisions or any regulation issued under PPA '06. See §601.601(d)(2) of this chapter. If section 1107 of PPA '06 applies to an amendment of a plan, section 1107 provides that the plan does not fail to meet the requirements of section 411(d)(6) by reason of such amendment, except as provided by the Secretary of the Treasury.[6] For example, section 411(d)(6) relief would be available for plan amendments that would prohibit single sum or other accelerated distributions if the plan's AFTAP was less than 60 percent, in accordance with section 436(d) and §1.436–1(d) of the proposed regulations. Plan sponsors should note that the IRS and the Treasury Department are reviewing whether sample plan amendments should be issued with respect to section 436 and the §1.436–1 regulations.

ERISA notice to participants and beneficiaries

Under section 101(j) of ERISA, as amended by PPA '06, the plan administrator of a single employer plan is required to provide a written notice to participants and beneficiaries within 30 days after:

- The date the plan has become subject to a restriction described in the ERISA provisions that are parallel to paragraphs (b) and (d) of Code section 436;
- In the case of a plan that is subject to the ERISA provisions that are parallel to paragraph (e) of Code section 436, the valuation date for the plan year for which the plan's AFTAP is less than 60 percent (or, if earlier, the date the AFTAP is presumed to be less than 60 percent under the ERISA provisions that parallel the presumption rules in paragraph (h) of Code section 436); and
- At such other time as may be determined by the Secretary of the Treasury.

The notice is required to be provided in writing, except that the notice may be in electronic or other form to the extent that such form is reasonably accessible to the recipient.

Effective/Applicability Dates

1. *Section 1.430(f)–1.*

In general, these regulations under section 430(f) are proposed to apply to plan years beginning on or after January 1, 2008. However, in the case of a plan for which the effective date of section 430 is delayed in accordance with sections 104 through 106 of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, the regulations under section 430(f) are proposed to apply to plan years beginning on or after the effective date of section 430 with respect to the plan. Unlike section 436, section 430 and the regulations under section 430(f) do not include a delayed effective date for collectively bargained plans.

2. *Section 1.436–1.*

In general, the regulations under section 436 are proposed to apply to plan years beginning on or after January 1, 2008. However, in the case of a plan for which the effective date of section 436 is delayed in accordance with sections 104 through 106 of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, the regulations under section 436 are proposed to apply to plan years beginning on or after the effective date of section 436 with respect to the plan. In addition, in the case of a collectively bargained plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before January 1, 2008, the regulations under section 436 would not apply to plan years beginning before the earlier of: (1) the later of the date on which the last collective bargaining agreement relating to the plan terminates (determined without

[5] H.R. 3361 (August 3, 2007) and S. 1974 (August 2, 2007), at sections 2(c)(1)(C), 2(c)(2)(C), 2(c)(1)(F), and 2(c)(2)(F).

[6] Except to the extent permitted under section 411(d)(6) and the §1.411(d)–4 regulations, or under a statutory provision such as section 1107 of PPA '06, section 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment. However, an amendment that eliminates or decreases benefits that have not yet accrued does not violate section 411(d)(6), provided the amendment is adopted and effective before the benefits accrue.

regard to any extension thereof agreed to after August 17, 2006), or the first day of the first plan year to which the proposed regulations under section 436 would otherwise apply, or (2) January 1, 2010. For this purpose, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement under the proposed regulations would not be treated as a termination of the collective bargaining agreement. The determination of whether a plan is a collectively bargained plan is the same as described above in paragraph II.A.5 of this preamble with respect to a plan sponsor's deemed election to reduce funding balances.

3. *Reliance on proposed regulations.*

For periods following the issuance of these proposed regulations and before final regulations are issued, these proposed regulations may be relied upon for plan qualification purposes, provided that such reliance is on a consistent and reasonable basis.

4. *Effect on plans subject to section 402 of PPA '06.*

The IRS and the Treasury Department are reviewing the applicability of section 436 and the funding balance rules of section 430(f) to plans that have made elections under section 402 of PPA '06 (taking into account the amendments to section 402 of PPA '06 by section 6615 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 (Public Law 110–28)) and any special rules for such plans will be addressed in future guidance.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information imposed by these proposed regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The estimated burden imposed by the collection of information contained in these proposed regulations is 0.75 hours per respondent. Moreover, most of this burden is attributable to the requirement for a qualified defined benefit plan's enrolled actuary to provide a timely certification of the plan's AFTAP for each plan year to avoid certain benefit restrictions, which is imposed by section 436(h) of the Code. In addition, these proposed regulations provide for several written elections to be made by the plan sponsor upon occasion; these written elections will require minimal time to prepare. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (one signed and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the Federal Register.

Drafting Information

The principal authors of these regulations are Lauson C. Green and Linda S.F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.430(f)–1 is added to read as follows:

§1.430(f)–1 Effect of prefunding balance and funding standard carryover balance.

(a) *In general*—(1) *Overview.* This section provides rules relating to the application of prefunding balances and funding standard carryover balances under section 430(f). Section 430 and this section apply to single employer defined benefit plans (including multiple employer plans) that are subject to section 412, but do not apply to multiemployer plans (as defined in section 414(f)). Paragraph (b) of this section sets forth rules regarding a plan sponsor's election to maintain a funding standard carryover balance or a prefunding balance. Paragraph (c) of this section provides rules under which those balances must be subtracted from plan assets. Paragraph (d) of this section describes a plan sponsor's election to use those balances to offset the minimum required contribution. Paragraph (e) of this section describes a plan sponsor's election to reduce those balances (which will affect the determination of the value of plan assets for purposes of sections 430 and 436). Paragraph (f) of this section sets forth rules regarding elections under this section. Paragraph (g) of this section contains examples. Paragraph (h) of this section contains effective/applicability dates and transitional provisions.

(2) *Special rules for multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, the rules of this section are applied separately for each employer under the plan, as if each employer maintained a separate plan. Thus, each employer under such a multiple employer plan may have a separate funding standard carryover balance and a prefunding balance for the plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), the rules of this section are applied as if all participants in the plan were employed by a single employer.

(b) *Election to maintain balances*—(1) *Prefunding balance*—(i) *In general.* A plan sponsor is permitted to maintain a prefunding balance for a plan. A prefunding balance maintained for a plan consists of a beginning balance of zero, increased by the amount of excess contributions to the extent the employer elects to do so as described in paragraph (b)(1)(ii) of this section, and decreased to the extent provided in paragraph (b)(1)(iii) of this section. The prefunding balance is adjusted further for investment return and interest as provided in paragraphs (b)(3) and (b)(4) of this section.

(ii) *Increases*—(A) *In general.* If the plan sponsor of a plan elects to add to the plan's prefunding balance, as of the first day of each plan year following the first effective plan year for the plan, the prefunding balance is increased by the amount so elected by the plan sponsor for the plan year. The amount added to the prefunding balance cannot exceed the interest-adjusted excess contributions for the preceding plan year determined under paragraph (b)(1)(ii)(B) of this section.

(B) *Interest-adjusted excess contribution.* For purposes of this paragraph (b)(1)(ii), the interest-adjusted excess contribution for the preceding plan year is the amount, increased with interest in accordance with the rules of paragraph (b)(1)(iv)(A) of this section, of the excess, if any, of—

(*1*) The present value of the employer contributions (other than contributions to avoid or terminate benefit limitations described in §1.436–1(f)(2)) to the plan for the preceding plan year determined under the rules of paragraph (b)(1)(iv)(B) of this section); over

(*2*) The minimum required contribution for the preceding plan year (determined without regard to any election to offset the minimum required contribution under paragraph (d) of this section for the preceding plan year).

(iii) *Decreases.* The prefunding balance of a plan is decreased (but not below zero) by the sum of—

(A) As of the first day of each plan year after the first effective plan year for the plan, any amount of the prefunding balance that was used under paragraph (d) of this section to offset the minimum required contribution of the plan for the preceding plan year; and

(B) As of the first day of each plan year, any reduction in the prefunding balance under paragraph (e) of this section for the plan year.

(iv) *Adjustments for interest*—(A) *Adjustment of excess contribution.* The amount of the excess contribution for the preceding year (as determined under paragraph (b)(1)(ii)(B) of this section) is increased for interest accruing for the period between the valuation date for the preceding plan year and the first day of the current year. For this purpose, interest is determined by using the plan's effective interest rate under section 430(h)(2)(A) for the preceding plan year.

(B) *Determination of present value.* The present value of the contributions described in paragraph (b)(1)(ii)(B)(*1*) of this section is determined as of the valuation date for the preceding plan year, using the plan's effective interest rate under section 430(h)(2)(A) for the preceding plan year.

(2) *Funding standard carryover balance*—(i) *In general.* A funding standard carryover balance is only permitted to be maintained by a plan that had a positive balance in the funding standard account under section 412(b) as of the end of the pre-effective plan year for the plan. The funding standard carryover balance as of the beginning of the first effective plan year for the plan is the positive balance in the funding standard account under section 412(b) as of the end of the pre-effective plan year for the plan, decreased to the extent provided in paragraph (b)(2)(ii) of this section and adjusted further for investment return and interest as provided in paragraphs (b)(3) and (b)(4) of this section.

(ii) *Decreases.* The funding standard carryover balance of a plan is decreased (but not below zero) by the sum of—

(A) As of the first day of each plan year after the first effective plan year for the plan, any amount of the funding standard carryover balance that was used under paragraph (d) of this section to offset the minimum required contribution of the plan for the preceding plan year; and

(B) As of the first day of each plan year, any reduction in the funding standard carryover balance under paragraph (e) of this section for the plan year.

(3) *Adjustments for investment experience.* In determining a plan's prefunding balance under paragraph (b)(1) of this section or a plan's funding standard carryover balance under paragraph (b)(2) of this section as of the first day of a plan year, the balance must be adjusted to reflect the actual rate of return on plan assets for the preceding plan year. This adjustment is applied to the balance after subtracting amounts used to offset the minimum required contribution for the preceding plan year pursuant to paragraph (d) of this section and after any reduction of balances for that preceding plan year under paragraph (e) of this section. For this purpose, the actual rate of return on plan assets for the preceding plan year is determined on the basis of fair market value and must take into account the amount and timing of all contributions, distributions, and other plan payments made during that period.

(4) *Valuation date other than the first day of the plan year*—(i) *In general.* If a plan's valuation date is not the first day of the plan year, solely for purposes of applying paragraphs (c), (d), and (e) of this section, the plan's prefunding balance and funding standard carryover balance (if any) determined under this paragraph (b) are increased to the valuation date using the plan's effective interest rate under section 430(h)(2)(A) for the plan year.

(ii) *Special rule for adjustments for investment experience.* For purposes of applying the rules regarding the adjustments for investment experience in paragraph (b)(3) of this section, in the case of a plan with a valuation date that is not the first day of the plan year, the amount of the funding balances that must be subtracted from plan assets under paragraph (d) of this section (because they are used to offset the minimum required contribution for the plan year) must be adjusted to the first day of the plan year using the effective interest rate under section 430(h)(2)(A) for that year.

(c) *Effect of balances on plan assets*—(1) *In general.* In the case of any plan with a prefunding balance or a funding standard carryover balance, the amount of those balances must be subtracted from the value of plan assets for purposes of sections 430 and 436, except as provided in paragraphs (c)(2), (c)(3), and (c)(4) of this section.

(2) *Subtraction of balances in determining new shortfall amortization base*—(i) *Prefunding balance.* For purposes of determining whether a plan is exempt from

the requirement to establish a new shortfall amortization base under section 430(c)(5), the amount of the prefunding balance is subtracted from the value of plan assets only if an election under paragraph (d) of this section to use the prefunding balance to offset the minimum required contribution is made for the plan year.

(ii) *Funding standard carryover balance.* For purposes of determining whether a plan is exempt from the requirement to establish a new shortfall amortization base under section 430(c)(5), the funding standard carryover balance is not subtracted from the value of plan assets regardless of whether any portion of either the funding standard carryover balance or the prefunding balance is used to offset the minimum required contribution for the plan year under paragraph (d) of this section.

(3) *Special rule for certain binding agreements with PBGC.* If there is in effect for a plan year a binding written agreement with the Pension Benefit Guaranty Corporation (PBGC) which provides that all or a portion of the prefunding balance or funding standard carryover balance (or both balances) is not available to offset the minimum required contribution for a plan year, that specified amount is not subtracted from the value of plan assets for purposes of determining the funding shortfall under section 430(c)(4). For example, if a PBGC agreement provides that $5 million of a plan's balances is unavailable to offset the minimum required contribution for a plan year, the sum of the plan's prefunding balance and funding standard carryover balance is $20 million, and the plan's assets are $100 million, the value of plan assets for purposes of determining the funding shortfall under section 430(c)(4) is reduced by $15 million ($20 million less $5 million) to $85 million. For purposes of this paragraph (c)(3), an agreement with the PBGC is taken into account with respect to a plan year only if the agreement was executed prior to the valuation date for the plan year.

(4) *Exception for section 436(j) and (k) special adjustment rules.* See section 436(j) and (k) and §1.436–1(j)(2)(ii) and (iii) for exceptions from the requirement to subtract the prefunding and funding standard carryover balances from plan assets in determining a plan's funding target attainment percentage for purposes of section 436.

(d) *Election to apply balances against minimum required contribution*—(1) *In general.* Subject to the limitations provided in paragraphs (d)(2) and (d)(3) of this section, in the case of any plan year in which the plan sponsor elects to use all or a portion of the prefunding balance or the funding standard carryover balance to offset the minimum required contribution for the current plan year, the minimum required contribution for the plan year (determined after taking into account any waiver under section 412(c)) is offset as of the valuation date for the plan year by the amount so used.

(2) *Requirement to use funding standard carryover balance before prefunding balance.* To the extent that a plan has a funding standard carryover balance greater than zero, no amount of the plan's prefunding balance may be used to offset the minimum required contribution. Thus, a plan's funding standard carryover balance must be exhausted before the plan's prefunding balance may be applied under paragraph (d)(1) of this section to offset the minimum required contribution.

(3) *Limitation for underfunded plans.* An election to apply a funding standard carryover balance or a prefunding balance under paragraph (d)(1) of this section is not available for a plan year if the plan's prior year funding ratio is less than 80 percent. For purposes of this paragraph (d)(3), except as provided in paragraph (h)(5) of this section, the plan's prior year funding ratio is the fraction (expressed as a percentage)—

(i) The numerator of which is the value of plan assets on the valuation date for the preceding plan year, reduced by the amount of any prefunding balance (but not the amount of any funding standard carryover balance); and

(ii) The denominator of which is the funding target of the plan for the preceding plan year (determined without regard to section 430(i)(1)).

(e) *Election to reduce balances*—(1) *In general.* A plan sponsor may make an election for a plan year to reduce any portion of a plan's prefunding balance and funding standard carryover balance under this paragraph (e). If such an election is made, the amount of those balances that must be subtracted from plan assets pursuant to paragraph (c)(1) of this section will be smaller and, accordingly, the plan assets taken into account for purposes of sections 430 and 436 will be larger. Thus, this election to reduce a plan's prefunding balance and funding standard carryover balance is taken into account in the determination of plan assets for the plan year and applies for all purposes under sections 430 and 436, including for purposes of determining the plan's prior year funding ratio under paragraph (d)(3) of this section for the following plan year. See also section 436(f)(3) and §1.436–1(a)(5) for a rule under which the plan sponsor is deemed to make the election described in this paragraph (e).

(2) *Coordination between prefunding balance and funding standard carryover balance.* To the extent that a plan has a funding standard carryover balance greater than zero, no election under paragraph (e)(1) of this section is permitted to be made that reduces the plan's prefunding balance. Thus, a plan must exhaust its funding standard carryover balance before it is permitted to make an election under paragraph (e)(1) of this section with respect to its prefunding balance.

(f) *Elections*—(1) *Method of making elections.* Any election under this section by the plan sponsor must be made by providing written notification of the election to the plan's enrolled actuary and the plan administrator. The written notification must set forth the relevant details of the election, including the specific amounts involved in the election with respect to the prefunding balance and funding standard carryover balance.

(2) *Timing of elections*—(i) *General rule.* Except as provided in paragraph (f)(2)(ii) of this section, any election under this section must be made on or before the due date (with extensions) for the filing of the plan's Form 5500, "*Annual Return/Report of Employee Benefit Plan*", for the plan year to which the election relates (or, in the case of a plan not required to file a Form 5500 for the plan year, on or before the last day of the seventh month after the end of the plan year to which the election relates). For this purpose, an election to add to the prefunding balance relates to the plan year for which excess contributions were made. For example, in the case of a plan required to file a Form 5500, an election to add to the prefunding balance

as of the first day of the 2010 plan year (in an amount not in excess of the 2009 interest-adjusted excess contributions under the rules of paragraph (b)(1)(ii) of this section) must be made no later than the due date for filing the 2009 Form 5500 even though the election is reported on the 2010 Form 5500 (Schedule SB).

(ii) *Election to reduce balances.* Any election under paragraph (e) of this section to reduce the prefunding balance or funding standard carryover balance for a plan year (for example, in order to avoid a benefit restriction under section 436) must be made by the end of the plan year to which the election relates.

(3) *Irrevocability of elections.* A plan sponsor's election under this section with respect to the plan's funding standard carryover balance or prefunding balance is irrevocable (and must be unconditional).

(4) *Plan sponsor*—(i) *In general.* For purposes of the elections described in this section, except as provided in paragraph (f)(4)(ii) of this section, any reference to the plan sponsor means the employer or employers responsible for making contributions to or under the plan.

(ii) *Certain multiple employer plans.* For purposes of the elections described in this section, in the case of plans that are multiple employer plans to which section 413(c)(4)(A) does not apply, any reference to the plan sponsor means the plan administrator within the meaning of section 414(g).

(g) *Examples.* The following examples illustrate the application of this section:

Example 1. (i) Plan P is a defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The funding standard carryover balance of Plan P is $25,000 as of the beginning of the 2008 plan year. The sponsor of Plan P, Sponsor S, does not elect in 2008, pursuant to paragraph (e)(1) of this section, to reduce any portion of the funding standard carryover balance prior to the determination of the value of plan assets. The actual rate of return on Plan P's assets in 2008 is 2%. The effective interest rate in 2008 for Plan P is 6%. The minimum required contribution for Plan P under section 430 for 2008 is $100,000. The prior year funding ratio for Plan P for 2008, as determined under paragraph (h)(5) of this section, is not less than 80%.

(ii) Sponsor S makes a contribution to Plan P of $150,000 on December 1, 2008, for the 2008 plan year and makes no other contributions for the 2008 plan year. Because this contribution was made on a date other than the valuation date for the 2008 plan year, the contribution must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at the effective rate of interest for the 2008 plan year. The amount of the contribution after adjustment is $142,198, determined as $150,000 discounted for 11 months of compound interest at an effective annual interest rate of 6%.

(iii) The excess of employer contributions for 2008 over the minimum required contribution for 2008, as of the valuation date, is $42,198 ($142,198 less $100,000). Accordingly, the increase in Plan P's prefunding balance as of January 1, 2009, cannot exceed $44,730 (which is the excess contribution of $42,198 adjusted for 12 months of interest at an effective interest rate of 6%).

(iv) Furthermore, if Sponsor S does not elect to apply any portion of the funding standard carryover balance toward the minimum contribution in 2008, the funding standard carryover balance as of January 1, 2009, is $25,500 (which is the funding standard carryover balance as of January 1, 2008, adjusted for investment experience at an effective interest rate of 2%).

Example 2. (i) The facts are the same as in *Example 1* except that the contribution of $150,000 is made on February 1, 2009, for the 2008 plan year.

(ii) The amount of the contribution after adjustment is $140,824, which is determined as $150,000 discounted for 13 months of interest at an effective interest rate of 6%. Accordingly, the increase in Plan P's prefunding balance as of January 1, 2009, cannot exceed $43,273 (which is the excess contribution of $40,824 adjusted for 12 months of interest at an effective interest rate of 6%).

Example 3. (i) The facts are the same as in *Example 1* except that Sponsor S contributes $85,000 to Plan P on January 1, 2008, for the 2008 plan year and makes no other contributions to Plan P for the 2008 plan year. In addition, Sponsor S elects to use $15,000 of the funding standard carryover balance to offset Plan P's minimum required contribution in 2008, pursuant to paragraph (d)(1) of this section.

(ii) With respect to the 2009 plan year, the adjustment for investment experience under paragraph (b)(3) of this section for the funding standard carryover balance for the preceding plan year is $200, determined as the actual rate of return on plan assets for 2008 as applied to the 2008 funding standard carryover balance after reduction for the amount of that balance used under paragraph (d)(1) of this section (that is, $25,000 less $15,000, multiplied by the actual rate of return of 2%).

(iii) The funding standard carryover balance, as of January 1, 2009, is $10,200, determined as the 2008 funding standard carryover balance less the amount used to offset the 2008 minimum required contribution, adjusted for investment experience during the 2008 year ($25,000 less $15,000 plus $200).

Example 4. (i) The facts are the same as in *Example 3* except that Sponsor S contributes $90,000 (instead of $85,000) to Plan P on January 1, 2008, for the 2008 plan year.

(ii) Notwithstanding the fact that the amount that Sponsor S contributed to Plan P exceeds the minimum required contribution ($85,000) after it has been offset as a result of the use of the funding standard carryover balance, the maximum amount that Sponsor S may add to the prefunding balance as of January 1, 2009, is $0. This is because the maximum amount that may be added to the prefunding balance is the excess of $90,000 over $100,000. See paragraphs (b)(1)(ii)(A) and (B) of this section.

Example 5. (i) Plan Q is a defined benefit plan with a plan year that is the calendar year and a valuation date of July 1. The funding standard carryover balance of Plan Q is $50,000 as of January 1, 2009, the beginning of the 2009 plan year. The prefunding balance of Plan Q as of the beginning of the 2009 plan year is $0. The actual rate of return on Plan Q's assets in 2009 is 10%. The effective interest rate for Plan Q for 2009 is 5%. The funding ratio for Plan Q in 2008 is 85%, as determined under paragraph (d)(3) of this section. Thus, the prior year funding ratio for 2009 is not less than 80%.

(ii) Pursuant to paragraph (b)(4) of this section, the funding standard carryover balance is increased to $51,235 as of July 1, 2009 (that is, an increase to reflect 6 months of interest at an effective interest rate of 5%). Sponsor T does not elect in 2009 to reduce any portion of the funding standard carryover balance pursuant to paragraph (e) of this section. The funding standard carryover balance ($51,235) is subtracted from the value of plan assets, as of July 1, 2009, prior to the determination of the minimum funding contribution and, accordingly, $51,235 is the maximum amount that may applied against the minimum required contribution.

(iii) The minimum required contribution for Plan Q for 2009 is $200,000. Sponsor T makes a contribution to Plan Q of $190,000 on July 1, 2009, for the 2009 plan year, and makes no other contributions for the 2009 plan year. Sponsor T elects to use $10,000 of the funding standard carryover balance to offset Plan Q's minimum required contribution in 2009. Accordingly, the value of the funding standard carryover balance as of July 1, 2009, prior to adjustment for investment experience, is $41,235 (that is, $51,235 less $10,000).

(iv) The value of the funding standard carryover balance as of January 1, 2010, is determined by first discounting the value as of July 1, 2009, after amounts have been used to offset the minimum required contribution, to January 1, 2009, at the effective interest rate and then crediting this so determined amount with a full year's investment experience at a rate equal to the actual rate of return. Thus, the July 1, 2009, value of $41,235 is discounted for 6 months of interest, at an effective interest rate of 5%, to obtain a January 1, 2009, value of $40,241. Accordingly, the value of the funding standard carryover balance as of January 1, 2010, is $44,265 (that is, $40,241 increased with one year's investment return at a rate of 10%).

(h) *Effective/applicablility date and transition rules*—(1) *General effective/applicability date.* Except as provided in paragraph (h)(2) of this section, this section applies to plan years beginning on or after January 1, 2008.

(2) *Plans with delayed effective date.* In the case of a plan for which the effective date of section 430 is delayed in accordance with sections 104 through 106 of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, this section applies to plan years beginning on or after the effective date of section 430 with respect to the plan.

(3) *First effective plan year.* For purposes of this section, the first effective plan year for a plan is the first plan year to which this section applies under paragraph (h)(1) or (h)(2) of this section.

(4) *Pre-effective plan year.* For purposes of this section, the pre-effective plan year for a plan is the last plan year beginning before the first effective date applicable under paragraph (h)(1) or (h)(2) of this section. Thus, except for plans with a delayed effective date under paragraph (h)(2) of this section, the pre-effective plan year for a plan is the last plan year beginning before January 1, 2008.

(5) *Special lookback rule for pre-effective plan year's funding ratio*—(i) *Plan assets.* For purposes of determining a plan's prior year funding ratio pursuant to paragraph (d)(3) of this section for the first effective plan year, the value of plan assets on the valuation date of the preceding plan year is determined under section 412(c)(2) as in effect for that pre-effective plan year, except that—

(A) If the value of plan assets is less than 90 percent of the fair market value of plan assets for the pre-effective plan year on that date, for this purpose such value is considered to be 90 percent of the fair market value; and

(B) If the value of plan assets is greater than 110 percent of the fair market value of plan assets on the valuation date for the pre-effective plan year on that date, for this purpose such value is considered to be 110 percent of the fair market value.

(ii) *Funding target.* For purposes of determining a plan's prior year funding ratio pursuant to paragraph (d)(3) of this section for the first effective plan year, the funding target of the plan for the preceding plan year is equal to the plan's current liability under section 412(l)(7) on the valuation date for the plan's pre-effective plan year.

Par. 3. Section 1.436–1 is added to read as follows:

§1.436–1 Limits on benefits and benefit accruals under single employer defined benefit plans.

(a) *General rules*—(1) *Qualification requirement.* Section 401(a)(29) provides that a defined benefit pension plan that is subject to section 412 and that is not a multiemployer plan (within the meaning of section 414(f)) is a qualified plan only if it satisfies the requirements of section 436. This section provides rules relating to funding-based limitations on certain benefits under section 436, and the requirements of section 436 are satisfied only if the plan meets the requirements of this section beginning with the plan's first effective plan year. This section applies to single employer defined benefit plans (including multiple employer plans), but does not apply to multiemployer plans.

(2) *Organization of the regulation.* Paragraph (b) of this section describes a limitation on shutdown benefits and other unpredictable contingent event benefits. Paragraph (c) of this section describes limitations on plan amendments increasing liabilities. Paragraph (d) of this section describes limitations on accelerated benefit payments. Paragraph (e) of this section describes limitations on benefit accruals. Paragraph (f) of this section provides rules relating to methods to avoid benefit limitations. Paragraph (g) of this section provides rules for the operation of the plan in relation to benefit limitations under section 436. Paragraph (h) of this section describes related presumptions regarding underfunding that apply for purposes of the benefit limitations under section 436. Paragraph (j) of this section contains definitions. Paragraph (k) of this section contains effective/applicability date provisions.

(3) *Special rules for certain plans*—(i) *New plans.* The limitations described in paragraphs (b), (c), and (e) of this section do not apply to a plan for the first 5 plan years of the plan. For purposes of applying this rule, plan years of a plan are aggregated with plan years of a predecessor plan in accordance with section 414(a) or §1.415(f)–1(c).

(ii) *Multiple employer plans.* In the case of a multiple employer plan to which section 413(c)(4)(A) applies, this section applies separately with respect to each employer under the plan, as if each employer maintained a separate plan. Thus, the benefit limitations under section 436 and this section could apply differently to participants who are employees of different employers under such a multiple employer plan. In the case of a multiple employer plan to which section 413(c)(4)(A) does not apply (that is, a plan described in section 413(c)(4)(B) that has not made the election for section 413(c)(4)(A) to apply), this section applies as if all participants in the plan were employed by a single employer.

(4) *Treatment of plan as of close of prohibited or cessation period*—(i) *Resumption of benefit payments and accruals*—(A) *Resumption of accelerated payments.* If a limitation on accelerated benefit payments under paragraph (d) of this section applied to a plan as of a section 436 measurement date, but that limit no longer applies to the plan as of a later section 436 measurement date, then the prohibition on paying accelerated benefits under the plan does not apply to benefits with annuity starting dates that are on or after that later section 436 measurement date. Any amendment to eliminate the payment of accelerated benefit payments for periods in which they are not restricted under section 436 is subject to the rules of section 411(d)(6).

(B) *Resumption of benefit accruals.* Unless the plan provides otherwise, benefit accruals under the plan resume effective as of the section 436 measurement date on which benefit accruals are no longer restricted under paragraph (e) of this section.

(ii) *Missed benefit payments and accruals*—(A) *Option to amend plan to restore benefits.* A plan is permitted to be amended to provide participants who had an annuity starting date within a period during which the rules of paragraph (d) of this section applied to the plan with the opportunity to have a new election under which the form of benefit previously elected may be modified, subject to applicable qualification requirements. A participant who makes such a new election is treated as having a new annuity starting date under section 417. Similarly, a plan is permitted to be amended to provide that any benefit accruals which were limited under the rules of paragraph (e) of this section are credited under the plan when the limitation no longer applies, subject to applicable qualification requirements. Any such plan amendment with respect to a new annuity starting date or crediting of benefit accruals is subject to the requirements of section 436(c) and paragraph (c) of this section.

(B) *Automatic plan provisions to restore benefits.* A plan is permitted to provide that participants who had an annuity starting date within a period during which

the rules of paragraph (d) of this section applied to the plan are automatically provided with the opportunity to have a new annuity starting date (which would constitute a new annuity starting date under section 417) under which the form of benefit previously elected may be modified, subject to applicable qualification requirements, once the rules of paragraph (d) of this section cease to apply. In addition, a plan is permitted to provide for the automatic restoration of benefit accruals that had been limited under section 436(e) as of the section 436 measurement date that the limitation ceases to apply, as described in paragraph (a)(4)(ii)(A) of this section. However, if a plan provides for the automatic restoration of those benefit accruals and the period of the limitation exceeds 12 months, the plan will be treated as having adopted, effective as of the section 436 measurement date on which the limitation ceases to apply, a plan amendment that has the effect of increasing liabilities under the plan. Such an amendment is subject to the limitations of paragraph (c) of this section.

(iii) *Shutdown and other unpredictable contingent event benefits*—(A) *In general.* If any unpredictable contingent event benefits under paragraph (b) of this section are limited with respect to an unpredictable contingent event, that limitation applies to all such benefits that otherwise would have been paid to any plan participant with respect to that unpredictable contingent event.

(B) *Benefits not paid.* Notwithstanding paragraph (a)(4)(iii)(A) of this section, a plan is permitted to be amended to provide that any unpredictable contingent event benefits that were limited under the rules of paragraph (b) of this section will be paid or reinstated as of the section 436 measurement date on which the limitation no longer applies, subject to applicable qualification requirements. Such a plan amendment is subject to the requirements of section 436(c) and paragraph (c) of this section. A plan is not permitted to provide for restoration of any such unpredictable contingent event benefits without an amendment that complies with section 436(c).

(iv) *Example.* The following example illustrates the application of this paragraph (a)(4):

Example. (i) Plan T is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. As of January 1, 2011, Plan T does not have a funding standard carryover balance or a prefunding balance. Plan T's sponsor is not in bankruptcy. Beginning January 1, 2011, Plan T is subject to the restriction on accelerated benefit distributions under paragraph (d)(3) of this section based on a presumed adjusted funding target attainment percentage (AFTAP) of 75%, and can therefore only pay a portion (generally 50%) of the accelerated benefit distributions otherwise payable to participants who commence benefit payments while the restriction is in effect.

(ii) U is a participant in Plan T. Participant U retires on February 1, 2011, and elects to receive benefits in the form of a single sum. However, because U elected a form of payment that is a prohibited payment that is not permitted to be paid under paragraph (d)(3)(i) of this section, U elects in accordance with paragraph (d)(3)(ii) of this section to receive 50% of his benefit in a single sum and the remainder as an immediately commencing straight life annuity.

(iii) On March 1, 2011, the enrolled actuary for the Plan certifies that the AFTAP for 2011 is 80%. Accordingly, beginning March 1, 2011, Plan T is no longer subject to the restriction under paragraph (d)(3) of this section.

(iv) Effective March 1, 2011, Plan T is amended to provide that a participant whose benefits were restricted under paragraph (d)(3) of this section may elect within a specified period on or after March 1, 2011, a new annuity starting date and receive the remainder of his or her pension benefits in an accelerated form of payment. Plan T's enrolled actuary determines that the AFTAP, taking into account the amendment, is still 80%. The amendment is permitted to take effect because Plan T has an AFTAP of 80% taking into account the amendment, and is therefore neither subject to the restriction on plan amendments in paragraph (c) of this section nor the restrictions on accelerated benefit payments under paragraphs (d)(1) and (d)(3) of this section. Accordingly, Participant U may elect, subject to otherwise applicable qualification rules, including spousal consent, to receive the remainder of his benefits in the form of a single sum on or after March 1, 2011.

(5) *Deemed election to reduce funding balances*—(i) *Limitations on accelerated benefit payments.* If a benefit limitation under paragraph (d) of this section would (but for this paragraph (a)(5)) apply to a plan, the employer is treated as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the adjusted funding target attainment percentage to be at or above the applicable threshold (60, 80, or 100 percent, as the case may be) in order for the benefit limitation not to apply to the plan. In such a case, the employer is treated as having made that election on the section 436 measurement date as of which the benefit limitation would otherwise apply (without regard to whether a participant is eligible for or requests a payment that is a prohibited payment described in paragraph (d)(5) of this section).

(ii) *Other limitations for collectively bargained plans*—(A) *General rule.* In the case of a collectively bargained plan to which a benefit limitation under paragraph (b), (c), or (e) of this section would (but for this paragraph (a)(5)) apply, the employer is treated as having made an election under section 430(f) to reduce the prefunding balance or funding standard carryover balance by such amount as is necessary for the adjusted funding target attainment percentage to be at or above the applicable threshold in order for the benefit limitation not to apply to the plan, taking into account the unpredictable contingent event benefits or plan amendment, as applicable. In such a case, the employer is treated as having made that election on the date as of which the applicable benefit limitation would otherwise apply.

(B) *Treatment of plans with both collectively bargained and non-collectively bargained employees.* In the case of a plan with respect to which collective bargaining agreements apply to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of this paragraph (a)(5)(ii) if at least 25 percent of the participants in the plan are members of collective bargaining units for which the benefit levels under the plan are specified under a collective bargaining agreement.

(iii) *Exception for insufficient funding balances*—(A) *In general.* Paragraphs (a)(5)(i) and (a)(5)(ii) of this section apply with respect to a benefit limitation for any plan year only if the application of those paragraphs would result in the corresponding benefit limitation not applying for such plan year. Thus, if the plan's prefunding and funding standard carryover balances were reduced to zero and the resulting increase in plan assets taken into account would still not increase the plan's adjusted funding target attainment percentage enough to reach the threshold percentage applicable to the benefit limitation, the deemed election to reduce those balances pursuant to paragraph (a)(5)(i) or (a)(5)(ii) of this section does not apply.

(B) *Presumed adjusted funding target attainment percentage less than 60 percent.* If a plan is presumed to have an adjusted funding target attainment percentage of less than 60 percent under para-

graph (h)(3) of this section, then the plan is treated as if the funding standard carryover balance and the prefunding balance are insufficient to increase the adjusted funding target attainment percentage to the threshold percentage of 60 percent. Accordingly, paragraphs (a)(5)(i) and (a)(5)(ii) of this section do not apply to such a plan.

(iv) *Example.* The following example illustrates the application of this paragraph (a)(5):

Example. (i) Plan W is a collectively bargained, single-employer defined benefit plan sponsored by Sponsor X, with a plan year that is the calendar year and a valuation date of January 1. Sponsor X is not in bankruptcy.

(ii) The enrolled actuary for Plan W issues a certification on March 1, 2010, that the 2010 AFTAP is 81%. Sponsor X adopts an amendment on March 25, 2010, to increase benefits under a formula based on participant compensation, with an effective date of May 1, 2010. (Because the formula is based on compensation, the exception in paragraph (c)(3) of this section for increases with respect to a formula not based on compensation does not apply.) The plan's enrolled actuary determines that the plan's AFTAP for 2010 would be 75% if the benefits attributable to the plan amendment were taken into account. This percentage is below the 80% threshold for the plan amendment limitation under paragraph (c) of this section.

(iii) Because the AFTAP would be below the 80% threshold if the benefits attributable to the plan amendment were taken into account, Sponsor X is deemed to have made an election under paragraph (a)(5)(ii) of this section to reduce Plan W's prefunding balance and funding standard carryover balance by the amount necessary for the AFTAP to reach the 80% threshold (reflecting the increase in funding target attributable to the plan amendment) in order for the limitation under paragraph (c) of this section not to apply.

(iv) In this case, provided the reduction in funding balances is sufficient for the limitation not to apply, the plan amendment will go into effect on its effective date (May 1). See paragraph (f) of this section for other methods to avoid benefit limitations (where, for example, the amount necessary for a benefit limitation not to apply for a plan year exceeds the aggregate funding balances).

(b) *Limitation on shutdown benefits and other unpredictable contingent event benefits*—(1) *In general.* A plan that contains an unpredictable contingent event benefit satisfies section 436(b) and this section only if it provides that the benefit will not be paid to a plan participant during a plan year if the adjusted funding target attainment percentage for the plan year—

(i) Is less than 60 percent; or

(ii) Is 60 percent or more, but would be less than 60 percent if the benefits attributable to the unpredictable contingent event were taken into account in determining the adjusted funding target attainment percentage.

(2) *Exemption*—(i) *In general.* The prohibition on payment of unpredictable contingent event benefits under paragraph (b)(1) of this section ceases to apply with respect to a plan year, effective as of the first day of the plan year, upon payment by the plan sponsor of the contribution described in paragraph (f)(2) of this section.

(ii) *Prior unpredictable contingent event.* Unpredictable contingent event benefits attributable to an unpredictable contingent event that occurred within a period during which no limitation under this paragraph (b) applied to the plan are not affected by the limitation described in this paragraph (b) as it applies in a subsequent period. For example, if a plant shutdown occurs in 2010 and the plan's funded status is such that shutdown benefits related to that shutdown are not subject to the limitation described in this paragraph (b) for that calendar plan year, this paragraph (b) will not apply to restrict payment of those shutdown benefits even if another shutdown occurs in 2012 that results in shutdown benefits related to that later shutdown being restricted under this paragraph (b) (where the plan's adjusted funding target attainment percentage for 2012 is less than 60 percent taking into account the liability attributable to those shutdown benefits).

(3) *Unpredictable contingent event.* For purposes of this section, an *unpredictable contingent event benefit* means any benefit or increase in benefits to the extent the benefit or increase would not be payable but for the occurrence of an unpredictable contingent event. For this purpose, an *unpredictable contingent event* means a plant shutdown (whether full or partial) or similar event, or an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability. Thus, for example, if a plan provides for an unreduced early retirement benefit upon the occurrence of an event other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability, then that unreduced early retirement benefit is an unpredictable contingent event benefit to the extent of any portion of the benefit that would not be payable but for the occurrence of the event, even if the remainder of the benefit is payable without regard to the occurrence of the event. Similarly, if a plan includes a benefit payable upon the presence of circumstances specified in the plan (other than the attainment of any age, performance of any service, receipt or derivation of any compensation, or the occurrence of death or disability), but not upon a severance from employment that does not include those circumstances, the plan is providing an unpredictable contingent event benefit.

(c) *Limitations on plan amendments increasing liability for benefits*—(1) *In general.* Except as provided in this paragraph (c), a plan satisfies section 436(c) and this section only if the plan provides that no amendment to the plan that has the effect of increasing liabilities of the plan by reason of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become nonforfeitable takes effect if the adjusted funding target attainment percentage for the plan year is—

(i) Less than 80 percent; or

(ii) Is 80 percent or more, but would be less than 80 percent if the benefits attributable to the amendment were taken into account in determining the adjusted funding target attainment percentage.

(2) *Exemption.* The limitations on plan amendments in paragraph (c)(1) of this section cease to apply and the amendment is permitted to take effect as of the later of the first day of the plan year or the effective date of the amendment upon payment by the plan sponsor of the contribution described in paragraph (f)(2) of this section.

(3) *Exception for certain benefit increases*—(i) *In general.* The limitation on plan amendments under paragraph (c)(1) of this section does not apply to any amendment that provides for an increase in benefits under a formula that is not based on a participant's compensation, but only if the rate of increase in benefits does not exceed the contemporaneous rate of increase in average wages of participants covered by the amendment. The determination of the rate of increase in average wages is made by taking into consideration the net increase in average wages from the period of time beginning with the effective date of the most recent benefit increase applicable to all of those participants who are covered by the current amendment and

ending on the effective date of the current amendment.

(ii) *Application to terminated participants.* If an amendment applies to both currently employed and terminated participants, all such participants must be included in determining the increase in average wages of the participants covered by the amendment. For this purpose, terminated participants are treated as having no increase or decrease in wages for the period after severance from employment.

(iii) *Separate amendments for different plan populations.* In lieu of a single amendment that applies to both currently employed participants and terminated participants as described in paragraph (c)(3)(ii) of this section, the employer could adopt two amendments — one that increases benefits for currently employed participants and another one that increases benefits for terminated participants. In that case, the two amendments are considered separately in determining the increase in average wages, and the exception in this paragraph (c)(3) from application of the section 436(c) limitation would apply separately to each amendment (so that an amendment providing for increases in benefits for currently employed participants could go into effect, but an amendment providing for increases in benefits for terminated participants who received no increase in wages from the employer during the period over which the increase in average wages is determined could not go into effect).

(4) *Exception for statutorily required vesting.* To the extent that any amendment results in (or is made pursuant to) a mandatory increase in the vesting of benefits under the Code or ERISA (such as vesting rate increases pursuant to statute, plan termination amendments under section 411(d)(3), and amendments that lead to vesting increases required by top heavy rules under section 416), that amendment does not constitute an amendment that changes the rate at which benefits become nonforfeitable for purposes of section 436(c) and this paragraph (c).

(d) *Limitations on accelerated benefit payments*—(1) *Funding percentage less than 60 percent*—(i) *In general.* A plan satisfies the requirements of section 436(d)(1) and this paragraph (d)(1) only if the plan provides that, if the plan's adjusted funding target attainment percentage for a plan year is less than 60 percent, the plan will not pay any prohibited payment with an annuity starting date on or after the applicable section 436 measurement date.

(ii) *Request for prohibited distribution.* If a participant or beneficiary requests a distribution that is prohibited under paragraph (d)(1)(i) of this section, the plan must permit the participant or beneficiary to elect another form of benefit available under the plan or to defer payment to a later date to the extent permitted under applicable qualification requirements.

(2) *Bankruptcy.* A plan satisfies the requirements of section 436(d)(2) and this paragraph (d)(2) only if the plan provides that the plan will not pay any prohibited payment with an annuity starting date that is during any period in which the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, except for payments made with an annuity starting date within a plan year that is on or after the date on which the enrolled actuary of the plan certifies that the plan's adjusted funding target attainment percentage for that plan year is not less than 100 percent. The rules of paragraph (d)(1)(ii) of this section apply if payments are prohibited under this paragraph (d)(2).

(3) *Limited payment if percentage at least 60 percent but less than 80 percent*—(i) *In general.* A plan satisfies the requirements of section 436(d)(3) and this paragraph (d)(3) only if the plan provides that, in any case in which the plan's adjusted funding target attainment percentage for a plan year is 60 percent or more but is less than 80 percent, a participant or beneficiary is permitted to elect the payment of a benefit with an annuity starting date on or after the applicable section 436 measurement date in the form of a prohibited payment only if the present value, determined in accordance with section 417(e)(3), of the portion of the payment that is greater than the amount of the straight life annuity under the plan (as described in paragraph (d)(5)(i)(A) of this section) does not exceed the lesser of—

(A) 50 percent of the present value of the benefits, determined in accordance with section 417(e)(3) (or, if greater, 50 percent of the amount of any single sum that would be payable without regard to this paragraph (d)); or

(B) 100 percent of the PBGC guarantee amount described in paragraph (d)(3)(iv) of this section.

(ii) *Bifurcation if optional form unavailable*—(A) *General rule.* If an optional form of benefit that is otherwise available under the terms of the plan is not available as of the annuity starting date because of the application of paragraph (d)(3)(i) of this section, then the plan must provide a participant or beneficiary who elects such an optional form with the option either to defer payment to a later date (to the extent permitted under applicable qualification requirements) or to bifurcate the benefit into unrestricted and restricted portions. If the participant or beneficiary elects to bifurcate the benefit, the plan must permit the participant or beneficiary to elect, with respect to the unrestricted portion, any optional form of benefit otherwise available under the plan with respect to the participant's or beneficiary's entire benefit (whether or not the optional form of benefit with respect to the unrestricted portion is a prohibited payment). In such a case, if the participant or beneficiary elects payment of the unrestricted portion of the benefit described in paragraph (d)(3)(ii)(B) of this section in the form of a prohibited payment, the plan must permit the participant or beneficiary to elect payment of the restricted portion described in paragraph (d)(3)(ii)(C) of this section in any optional form of benefit under the plan that is not a prohibited payment and that would have been permitted with respect to the participant's or beneficiary's entire benefit. A plan is also permitted to offer optional forms of benefit that are solely available during the period this paragraph (d)(3) applies to the plan, such as an optional form of benefit that provides for the current payment of the unrestricted portion of the benefit, with a delayed commencement for the restricted portion of the benefit, subject to other applicable qualification requirements.

(B) *Unrestricted portion of the benefit.* The unrestricted portion of the benefit is the lesser of—

(*1*) 50 percent of the benefit; and

(*2*) The portion of the benefit that has a present value equal to the PBGC guarantee amount described in paragraph (d)(3)(iv) of this section.

(C) *Restricted portion of the benefit.* The restricted portion of the benefit is the

portion of the benefit that is not described in paragraph (d)(3)(ii)(B) of this section.

(iii) *One-time application*—(A) *In general*. A plan satisfies the requirements of this paragraph (d) only if the plan provides that, in the case of a participant who receives a prohibited payment (or series of prohibited payments under a single optional form of benefit) pursuant to paragraph (d)(3)(i) or (ii) of this section, the participant cannot thereafter receive any additional prohibited payment during any period of consecutive plan years to which the limitations under either this paragraph (d)(3), paragraph (d)(1) of this section, or paragraph (d)(2) of this section apply.

(B) *Treatment of beneficiaries*. For purposes of this paragraph (d)(3), benefits provided to a participant and any beneficiary (including an alternate payee, as defined in section 414(p)(8)) are aggregated. If the accrued benefit of a participant is allocated to such an alternate payee and one or more other persons, the unrestricted amount under paragraphs (d)(3)(i) and (d)(3)(ii) of this section is allocated among such persons in the same manner as the accrued benefit is allocated, unless a qualified domestic relations order (as defined in section 414(p)(1)(A)) with respect to the participant or the alternate payee provides otherwise.

(iv) *Present value of PBGC maximum benefit guarantee*. The amount described in this paragraph (d)(3)(iv) is, with respect to a participant, the present value (determined under guidance prescribed by the Pension Benefit Guaranty Corporation, using the interest and mortality assumptions under section 417(e)) of the maximum benefit guarantee under section 4022 of ERISA.

(v) *Examples*. The following examples illustrate the application of this paragraph (d)(3):

Example 1. (i) Plan A is subject to the restriction on accelerated benefit distributions under paragraph (d)(3) of this section for the 2010 plan year, and can therefore only pay a portion of the accelerated benefit payments otherwise payable to participants whose annuity starting date occurs while the restriction applies.

(ii) Participant P is not married, and retires at age 65 during 2010, while the restriction under paragraph (d)(3) of this section applies to Plan A. P's accrued benefit is $10,000 per month, payable commencing at age 65 as a straight life annuity. Plan A provides for an optional single sum payment (subject to the restrictions under section 436) equal to the present value of the participant's accrued benefit using actuarial assumptions under section 417(e). P's single sum payment, determined without regard to this paragraph (d), is calculated to be $1,416,000, payable at age 65.

(iii) The PBGC guaranteed monthly benefit for a straight life annuity payable at age 65 in 2010 (for purposes of this example) is $4,500. The present value of the PBGC guaranteed benefit using actuarial assumptions under section 417(e) is $637,200.

(iv) Because Participant P retires during a period when the restriction in paragraph (d)(3) of this section applies to Plan A, only a portion of the benefit can be paid in the form of a single sum. P elects a single sum payment. Because a single sum payment is a prohibited payment, a determination must be made whether the payment can be paid under paragraph (d)(3)(i) of this section. In this case, because the portion of Participant P's benefit that is greater than a straight life annuity exceeds the lesser of 50% of the benefit otherwise payable, or the present value of the PBGC guaranteed benefit, it cannot be paid under paragraph (d)(3)(i) of this section. Accordingly, the maximum single sum that Participant P can receive is $637,200 (that is, the lesser of 50% of $1,416,000 or $637,200).

(v) Pursuant to paragraph (d)(3)(ii) of this section, the plan must offer P the option to bifurcate the benefit into restricted and unrestricted portions. The unrestricted portion is a monthly straight life annuity of $4,500, which can be paid in a single sum of $637,200. If P elects to receive the unrestricted portion of the benefit in the form of a single sum, then, with respect to the $5,500 restricted portion, the plan must permit P to elect any form of benefit that would otherwise be permitted with respect to the full $10,000 that is not a prohibited payment. Alternatively, the plan could permit P to elect to defer commencement of the restricted portion, subject to applicable qualification rules.

Example 2. (i) The facts are the same as in *Example 1*. In addition, Plan A provides an optional form of payment (subject to any benefit restrictions under section 436) that consists of a partial payment equal to the total return of employee contributions to the plan accumulated with interest, with an annuity payment for the remainder of the participant's benefit.

(ii) Participant Q is not married, and retires at age 65 during 2010, while Plan A is subject to the restriction under paragraph (d)(3) of this section. Participant Q has an accrued benefit equal to a straight life annuity of $3,000 per month. Under the optional form described in paragraph (i) of this *Example 2*, Q may elect a partial payment of $99,120 (representing the return of employee contributions accumulated with interest) plus a straight life annuity of $2,300 per month. The present value of Participant Q's accrued benefit, using actuarial assumptions under section 417(e), is $424,800. The present value of the PBGC guarantee payable at age 65 in the form of a straight life annuity is determined to be $637,200 for the purposes of this *Example 2*.

(iii) Under the bifurcation approach of paragraph (d)(3)(ii) of this section, Q can receive the partial single sum payment available under the terms of Plan A as long as the amount of the single sum does not exceed the unrestricted portion of the benefit under paragraph (d)(3)(ii)(B) of this section. The unrestricted portion of Q's benefit is the lesser of 50% of the benefit otherwise payable, or the present value of the PBGC guaranteed benefit. Accordingly, the maximum single sum that Q can receive is $212,400 (that is, the lesser of 50% of $424,800, or $637,200).

(iv) Because the present value of the portion of Q's benefit that is greater than the straight life annuity ($99,120) is less than the lesser of 50% of the present value of benefits (50% of $424,800) and $637,200 (100% of the PBGC guaranteed benefit), the optional form described in paragraph (i) of this *Example 2* is permitted to be paid under paragraph (d)(3)(i) of this section.

(4) *Exception for cessation of benefit accruals*. This paragraph (d) does not apply to a plan for a plan year if the terms of the plan, as in effect for the period beginning on September 1, 2005, provided for no benefit accruals with respect to any participants. If a plan that is described in this paragraph (d)(4) provides for benefit accruals during any time after September 1, 2005, this paragraph (d)(4) ceases to apply for the plan as of the date any benefits accrue under the plan.

(5) *Prohibited payment*—(i) *In general*. For purpose of this paragraph (d), the term *prohibited payment* means—

(A) Any payment for a month that is in excess of the monthly amount paid under a straight life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)) to a participant or beneficiary whose annuity starting date occurs during any period that a limitation under this paragraph (d) is in effect;

(B) Any payment for the purchase of an irrevocable commitment from an insurer to pay benefits; and

(C) Any other payment that is identified as a prohibited payment by the Commissioner in revenue rulings and procedures, notices and other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(ii) *Annuity starting date*. Solely for purposes of applying the limitations on accelerated benefit payments under this paragraph (d), the term *annuity starting date* means, as applicable—

(A) The first day of the first period for which an amount is payable as an annuity as described in section 417(f)(2)(A)(i);

(B) In the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred (including the participant's election, the participant's severance from employment if the participant is below normal retirement age, and, if applicable, the participant's survival to the date as of which payment is made)

which entitle the participant to such benefit as described in section 417(f)(2)(A)(ii);

(C) In the case of an amount payable under a retroactive annuity starting date, the benefit commencement date; and

(D) The date of any payment for the purchase of an irrevocable commitment from an insurer to pay benefits under the plan.

(6) *Involuntary distributions under section 411(a)(11).* [Reserved].

(e) *Limitation on benefit accruals for plans with severe funding shortfalls*—(1) *In general.* A plan satisfies the requirements of section 436(e) and this paragraph (e) only if it provides that, in any case in which the plan's adjusted funding target attainment percentage for a plan year is less than 60 percent, benefit accruals under the plan will cease as of the applicable section 436 measurement date. If a plan is required to cease benefit accruals under this paragraph (e), then the plan is not permitted to be amended in a manner that would increase the liabilities of the plan by reason of an increase in benefits or establishment of new benefits. The preceding sentence applies regardless of whether an amendment would otherwise be permissible under paragraph (c)(3) of this section.

(2) *Exemption.* The prohibition on additional benefit accruals under a plan described in paragraph (e)(1) of this section ceases to apply with respect to any plan year, effective as of the first day of the plan year, upon payment by the plan sponsor of the contribution described in paragraph (f)(2) of this section.

(f) *Methods to avoid benefit limitations*—(1) *In general.* This paragraph (f) sets forth rules relating to employer contributions and other methods to avoid the application of section 436 limitations under a plan for a plan year. In general, there are four methods a plan sponsor may utilize to avoid or terminate one or more of the benefit limitations under this section for a plan year. Two of these methods (where the plan sponsor elects to reduce the prefunding balance or funding standard carryover balance and where the plan sponsor makes additional contributions under section 430 for the prior plan year within the time period provided by section 430(j)(1) which are not added to the prefunding balance) involve increasing the amount of plan assets which are taken into account in determining the adjusted funding target attainment percentage. The other two methods (making a contribution that is specifically designated as a current year contribution to avoid application of a benefit limitation under paragraph (b), (c), or (e) of this section, and providing security under section 436(f)(1)) are described in paragraphs (f)(2) and (f)(3) of this section, respectively.

(2) *Current year contributions to avoid or terminate benefit limitations*—(i) *General rules*—(A) *Amount of contribution*—*(1) In general.* This paragraph (f)(2) sets forth rules regarding contributions to avoid the application of section 436 limitations under a plan for a plan year that apply to unpredictable contingent event benefits, plan amendments that increase liabilities for benefits, and benefit accruals.

(2) Interest adjustment. Any contribution made by a plan sponsor pursuant to this paragraph (f)(2) on a date other than the valuation date for the plan year must be adjusted with interest at the plan's effective interest rate under section 430(h)(2)(A) for the plan year. If the plan's effective interest rate for the plan year has not been determined at the time of the contribution, then this interest adjustment must be made using the highest of the three segment rates as applicable for the plan year under section 430(h)(2)(C). In such a case, if the effective interest rate for the year under section 430(h)(2)(A) is subsequently determined to be less than that highest rate, the excess is recharacterized as a section 430 contribution for the current plan year.

(B) *Prefunding balance or funding standard carryover balance may not be used.* No prefunding balance or funding standard carryover balance under section 430(f) may be used as a contribution described in this paragraph (f)(2). However, a plan sponsor is permitted to elect to reduce the funding standard carryover balance or the prefunding balance in order to increase the adjusted funding target attainment percentage for a plan year. See paragraph (a)(5) of this section for a rule mandating such a reduction in certain situations.

(ii) *Section 436 contributions separate from minimum required contributions*—(A) *In general.* The contributions described in this paragraph (f)(2) are contributions described in section 436(b)(2), (c)(2), and (e)(2), and are separate from any minimum required contributions under section 430. Thus, if a plan sponsor makes a contribution described in this paragraph (f)(2) for a plan year but does not make the minimum required contribution for the plan year, the plan will fail to satisfy the minimum funding requirements under section 430 for the plan year. In addition, a contribution described in this paragraph (f)(2) is disregarded in determining the prefunding balance under section 430(f)(6) and §1.430(f)–1(b)(1)(i).

(B) *Designation requirement.* Any contribution made by a plan sponsor pursuant to this paragraph (f)(2) must be designated as such at the time the contribution is used to avoid or terminate the limitations under this paragraph (f)(2) and, except as specifically provided in paragraph (g) or (h) of this section, cannot subsequently be recharacterized with respect to any plan year as a contribution to satisfy a minimum required contribution obligation, or otherwise. The designation must be made in accordance with the rules and procedures that otherwise apply to elections under §1.430(f)–1(f) with respect to funding balances.

(iii) *Contribution for unpredictable contingent event benefits.* In the case of a contribution to avoid the application of the limitation on benefits attributable to an unpredictable contingent event under section 436(b)—

(A) If the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the unpredictable contingent event benefits is less than 60 percent, then the amount of the contribution under section 436(b)(2) is equal to the amount of the increase in the funding target of the plan for the plan year if the benefits attributable to the unpredictable contingent event were included in the determination of the funding target.

(B) If the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the unpredictable contingent event benefits is 60 percent or more, then the amount of the contribution under section 436(b)(2) is the amount that would be sufficient to result in an adjusted funding target attainment percentage for the plan year of 60 percent if—

(*1*) The benefits attributable to the unpredictable contingent event were included in the determination of the funding target; and

(*2*) The contribution were included as part of the assets of the plan.

(iv) *Contribution for plan amendments increasing liability for benefits*. In the case of a contribution to avoid the application of the limitation on benefits attributable to a plan amendment under section 436(c)—

(A) If the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the plan amendment is less than 80 percent, then the amount of the contribution under section 436(c)(2) is equal to the amount of the increase in the funding target of the plan for the plan year if the liabilities attributable to the amendment were included in the determination of the funding target.

(B) If the adjusted funding target attainment percentage for the plan year determined without taking into account the liability attributable to the plan amendment is 80 percent or more, then the amount of the contribution under section 436(c)(2) is the amount that would be sufficient to result in an adjusted funding target attainment percentage for the plan year of 80 percent if—

(*1*) The liabilities attributable to the plan amendment were included in the determination of the funding target; and

(*2*) The contribution were included as part of the assets of the plan.

(v) *Contribution required for continued benefit accruals*. In the case of a contribution to avoid the application of the limitation on accruals under section 436(e), the amount of the contribution under section 436(e)(2) is equal to the amount sufficient to result in an adjusted funding target attainment percentage for the plan year of 60 percent if the contribution were included as part of the assets of the plan.

(3) *Security to increase adjusted funding target attainment percentage*—(i) *In general*. For purposes of avoiding benefit limitations under section 436, a plan sponsor may provide security in the form described in paragraph (f)(3)(ii) of this section. In such a case, the adjusted funding target attainment percentage for the plan year is determined by treating as an asset of the plan any security provided by a plan sponsor by the valuation date for the plan year in a form meeting the requirements of paragraph (f)(3)(ii) of this section. However, this security is not taken into account as a plan asset for any other purpose, including section 430.

(ii) *Form of security*. The forms of security permitted under paragraph (f)(3)(i) of this section are limited to—

(A) A bond issued by a corporate surety company that is an acceptable surety for purposes of section 412 of ERISA; or

(B) Cash, or United States obligations which mature in 3 years or less, held in escrow by a bank or an insurance company.

(iii) *Enforcement*. Any form of security provided under paragraph (f)(3)(i) of this section must provide—

(A) That it will be paid to the plan upon the earliest of—

(*1*) The plan termination date as defined in section 4048 of ERISA;

(*2*) If there is a failure to make a payment of the minimum required contribution for any plan year beginning after the security is provided, the due date for the payment under section 430(j)(1) or 430(j)(3); or

(*3*) If the plan's adjusted funding target attainment percentage is less than 60 percent (without regard to any security provided under this paragraph (f)(3)) for a consecutive period of 7 years, the valuation date for the last year in the 7-year period; and

(B) That the plan administrator must notify the surety, bank, or insurance company that issued or holds the security of any event described in paragraph (f)(3)(iii)(A) of this section within 10 days of its occurrence.

(iv) *Release of security*. The form of security is permitted to provide that it will be released (and any amounts thereunder will be refunded together with any interest accrued thereon) as provided in the agreement governing the escrow, but such release is not permitted until the plan's enrolled actuary has certified that the plan's adjusted funding target attainment percentage for a plan year is at least 90 percent (without regard to any security provided under this paragraph (f)(3)).

(v) *Contribution of security to plan*. Any amount of security provided under this paragraph (f)(3) that is subsequently turned over to the plan (whether pursuant to the enforcement mechanism of paragraph (f)(3)(iii) of this section or after its release under paragraph (f)(3)(iv) of this section) is treated as a contribution by the plan sponsor under section 430 when contributed and, if turned over pursuant to paragraph (f)(3)(iii) of this section, is not a contribution under paragraph (f)(2) of this section.

(4) *Examples*. The following examples illustrate the application of this paragraph (f):

Example 1. (i) Plan Z is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. Plan Z's sponsor is not in bankruptcy and did not purchase any annuities in 2009 or 2010. As of January 1, 2011, Plan Z does not have a funding standard carryover balance or a prefunding balance. As of that date, Plan Z has plan assets (and adjusted plan assets) of $2,000,000 and a funding target (and an adjusted funding target) of $2,550,000. On March 1, 2011, the enrolled actuary for the plan certifies that the AFTAP as of January 1, 2011, is 78.43%. The effective rate of interest for Plan Z for the 2011 plan year is 5.5%.

(ii) On May 1, 2011, the plan sponsor amends Plan Z to increase benefits. The enrolled actuary for the plan determines that the present value, as of January 1, 2011, of the increase in the funding target due to this amendment is $400,000. Because the AFTAP prior to the plan amendment is less than 80%, Plan Z is subject to the restriction on plan amendments in paragraph (c) of this section, and the amendment cannot take effect unless the employer utilizes one of the methods described in paragraph (f) of this section to avoid benefit limitations.

(iii) In order for this amendment to be permitted to become effective, the plan sponsor makes a contribution described in paragraph (f)(2) of this section. Because the AFTAP prior to the amendment was less than 80%, the provisions of paragraph (f)(2)(iv)(A) of this section apply. The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan amendments under paragraph (c) of this section is equal to the amount of the increase in the funding target attributable to the amendment, or $400,000. Under the provisions of paragraph (f)(2)(iv)(A) of this section, this contribution is required even though, if the contribution were included as part of the plan assets and the liability attributable to the plan amendment were included in the funding target, the AFTAP would be 81.36% (because the adjusted plan assets would have been $2,400,000 and the adjusted funding target would have been $2,950,000 (that is, adjusted plan assets of $2,000,000 plus the contribution of $400,000 as of January 1, 2011; divided by the adjusted funding target of $2,550,000 increased to reflect the additional $400,000 in the funding target attributable to the plan amendment)).

(iv) However, because the contribution is not paid until May 1, 2011, the necessary contribution amount must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at Plan Z's effective rate of interest for the 2011 plan year. The amount of the required contribution after adjustment is $407,203, determined as $400,000 increased for 4 months of compound interest at an effective annual interest rate of 5.5%.

(v) A contribution of $407,203 is made on May 1, 2011, and is designated as a contribution under

paragraph (f)(2) of this section. Accordingly, the contribution is not applied toward minimum funding requirements under section 430, and is not eligible for inclusion in the prefunding balance under §1.430(f)–1(b)(1). Since this contribution meets the requirements of paragraph (f)(2) of this section, the plan amendment can take effect.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan is in at-risk status under section 430(i). The funding target determined under section 430(i) is $2,600,000, and the funding target determined without regard to section 430(i) is $2,550,000.

(ii) On May 1, 2011, the plan sponsor amends Plan Z to increase benefits. The plan's enrolled actuary determines that the present value as of January 1, 2011 of the increase in the funding target due to the amendment (taking into account the at-risk status of the plan) is $440,000. Because the AFTAP prior to the plan amendment is less than 80%, Plan Z is subject to the restriction on plan amendments in paragraph (c) of this section, and the amendment cannot take effect unless the employer utilizes one of the methods described in paragraph (f) of this section to avoid benefit limitations.

(iii) In order for this amendment to be permitted to become effective, the plan sponsor makes a contribution described in paragraph (f)(2) of this section. Because the AFTAP prior to the amendment was less than 80%, the provisions of paragraph (f)(2)(iv)(A) of this section apply. The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan amendments under paragraph (c) of this section is equal to the amount of the increase in funding target attributable to the amendment, or $440,000. Under the provisions of paragraph (f)(2)(iv)(A) of this section, this contribution is required even though, if the contribution were included as part of the plan assets and the liability attributable to the plan amendment were included in the funding target, the AFTAP would exceed 80%.

(iv) However, because the contribution is not paid until May 1, 2011, the necessary contribution amount must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at Plan Z's effective rate of interest for the 2011 plan year. The amount of the required contribution after adjustment is $447,923, determined as $440,000 increased for 4 months of compound interest at an effective annual interest rate of 5.5%.

(v) A contribution of $447,923 is made on May 1, 2011, and is designated as a contribution under paragraph (f)(2) of this section. Accordingly, the contribution is not applied toward minimum funding requirements under section 430, and is not eligible for inclusion in the prefunding balance under §1.430(f)–1(b)(1). Since this contribution meets the requirements of paragraph (f)(2) of this section, the plan amendment can take effect.

Example 3. (i) The facts are the same as in *Example 1*, except that the enrolled actuary for the plan does not issue the certification of the 2011 AFTAP until September 1, 2011. Prior to October 1, 2010, the enrolled actuary had certified the 2010 AFTAP to be 82%. The highest of the three segment rates applicable to the 2011 plan year under section 430(h)(2)(C) is 6%.

(ii) Because the enrolled actuary has not certified the actual AFTAP as of January 1, 2011, and the amendment is scheduled to take effect after April 1, 2011, the rules of paragraph (h)(2)(ii) of this section apply. Accordingly, the AFTAP for 2011 (prior to reflecting the effect of the amendment) is presumed to be 10 percentage points lower than the 2010 AFTAP, or 72%. Because this presumed AFTAP is less than 80%, the restriction on plan amendments in paragraph (c) of this section applies, and the plan amendment cannot take effect.

(iii) In order to allow the plan amendment to take effect, the plan sponsor decides to make a contribution under paragraph (f)(2) of this section on May 1, 2011. Because the presumed AFTAP was less than 80% prior to reflecting the plan amendment, the rules of paragraph (f)(2)(iv)(A) of this section apply, and the amount of the contribution under section 436(c)(2) is the amount of the increase in the funding target for the year if the plan amendment were included in the determination of the funding target. Accordingly, an additional contribution of $400,000 is required as of January 1, 2011, to avoid the restriction on plan amendments under paragraph (c) of this section.

(iv) However, since the contribution is not made until May 1, 2011, the amount of the required contribution must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution. Since the effective interest rate has not yet been determined, the interest adjustment is based on the highest of the three segment rates applicable for the 2011 plan year under section 430(h)(2)(C), or 6%. The amount of the required contribution after adjustment is $407,845, determined as $400,000 increased for 4 months of compound interest at the highest segment interest rate for 2011, or 6%.

(v) Once the plan's effective interest rate has been determined, if that rate for the year is less than 6%, the amount of excess interest previously contributed is recharacterized as a section 430 contribution for the current plan year.

(g) *Rules of operation for periods prior to and after certification*—(1) *In general.* Section 436(h) and paragraph (h) of this section set forth a series of presumptions that apply before the enrolled actuary for a plan issues a certification of the plan's adjusted funding target attainment percentage for a plan year. This paragraph (g) sets forth rules for the application of limitations under sections 436(b), 436(c), 436(d), and 436(e) prior to and during the period those presumptions apply to a plan, and describes the interaction of those presumptions with plan operations after the plan's enrolled actuary has issued a certification of the plan's adjusted funding target attainment percentage for the plan year. Paragraph (g)(2) of this section sets forth rules that apply to periods during which a presumption under section 436(h) applies. Paragraph (g)(3) of this section sets forth rules that apply to periods during which no presumptions under section 436(h) apply but which are prior to the enrolled actuary's certification of the plan's adjusted funding target attainment percentage for the plan year. Paragraph (g)(4) of this section sets forth rules that apply after the enrolled actuary's certification of the plan's adjusted funding target attainment percentage for a plan year. Paragraph (g)(5) of this section sets forth additional rules that apply prior to the enrolled actuary's certification of the adjusted funding target attainment percentage for a plan year with respect to the limitations on unpredictable contingent event benefits and plan amendments that increase liabilities under paragraphs (b) and (c) of this section, respectively. Paragraph (g)(6) of this section sets forth rules for multiple unpredictable contingent events and amendments during a plan year. Paragraph (g)(7) of this section sets forth examples of the application of this paragraph (g).

(2) *Periods prior to certification during which a presumption applies*—(i) *Plan must follow presumptions.* A plan must provide that, for any period during which paragraph (h)(1), (2), or (3) of this section applies to the plan, the limitations applicable under paragraphs (b), (c), (d), and (e) of this section apply to the plan as if the actual adjusted funding target attainment percentage for the year were the presumed adjusted funding target attainment percentage determined under the rules of paragraph (h) of this section.

(ii) *Determination of amount of reduction in balances*—(A) *Valuation date adjustment.* During the period described in this paragraph (g)(2), the rules of paragraph (a)(5) of this section (relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance) must be applied based on the presumed percentage with respect to the limitations under paragraphs (b), (c), (d), and (e) of this section. In order to determine the amount of the reduction in those balances that would apply in such a situation, a presumed adjusted funding target must be established, which is then compared to the interim value of adjusted plan assets as of the valuation date for the current plan year. For this purpose, the interim value of adjusted plan assets is equal to the value of adjusted plan assets as of the valuation date, determined

without regard to future contributions, future elections to add to the prefunding balance for the prior year, and future elections (including deemed elections under paragraph (a)(5) of this section) to reduce the prefunding and funding standard carryover balances for the current plan year, and the presumed adjusted funding target is equal to the interim value of adjusted plan assets for the plan year divided by the presumed adjusted funding target attainment percentage.

(B) *Change in presumed percentage in 4th month.* If the presumed adjusted funding target attainment percentage for the plan year changes during the year because of application of the presumption in paragraph (h)(2) of this section, the rules regarding the deemed election to reduce funding balances described in paragraph (a)(5) of this section must be reapplied based on the new presumed adjusted funding target attainment percentage. This will typically occur on the first day of the 4th month of a plan year, but could happen later if the enrolled actuary's certification of the adjusted funding target attainment percentage for a plan year occurs after the first day of the 4th month of the following plan year. In order to perform this reapplication, a new adjusted funding target must be determined based on the new presumed adjusted funding target attainment percentage and must be compared to an updated interim value of adjusted plan assets. For this purpose, the new presumed adjusted funding target is redetermined based on the new presumed adjusted funding target attainment percentage, and is compared to the adjusted plan assets updated to take into account the plan sponsor's contributions made for the prior plan year and section 430(f) elections with respect to the plan's prefunding and funding standard carryover balances since the earlier determination of the interim plan assets. This reapplication of the deemed election may require an additional reduction in funding balances if the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of the limitation under paragraph (d) or (e) of this section is greater than the amount that was initially reduced. Prior reductions of funding balances continue to apply in accordance with the rules of paragraph (g)(4)(i)(C) of this section.

(iii) *Bankruptcy of plan sponsor.* Pursuant to section 436(d)(2), during any period in which the plan sponsor of a plan is a debtor in a case under title 11, United States Code, or any similar Federal or State law (as described in paragraph (d)(2) of this section), if the plan's enrolled actuary has not yet certified the plan's adjusted funding target attainment percentage for the plan year to be at least 100 percent, no prohibited payments within the meaning of paragraph (d)(5) of this section may be paid. Thus, the presumption rules of paragraph (h) of this section do not apply for purposes of section 436(d)(2) and this paragraph (g)(2)(iii).

(iv) *Application to unpredictable contingent events and plan amendments.* For purposes of applying the limitations under paragraphs (b) and (c) of this section during the period described in this paragraph (g)(2), the presumed adjusted funding target under paragraph (g)(2)(ii) of this section is adjusted to reflect the increase in the funding target that would be attributable to the unpredictable contingent event or the plan amendment if the unpredictable contingent event benefits or the increase in liability attributable to the plan amendment were taken into account. See paragraph (g)(5)(i) of this section for related rules regarding funding balances that apply in the case of unpredictable contingent event benefits or plan amendments increasing benefit liabilities.

(3) *Periods prior to certification during which no presumption applies*—(i) *Accelerated benefit payments and benefit accruals.* If no presumptions under section 436(h) apply to a plan during a period and the plan's enrolled actuary has not yet issued the certification of the plan's actual adjusted funding target attainment percentage for the plan year, the plan is not permitted to limit the payment of accelerated benefits under paragraph (d) of this section or the accrual of benefits under paragraph (e) of this section based on an expectation that those paragraphs will apply to the plan once an actuarial certification is issued. However, see paragraph (g)(2)(iii) of this section for a restriction on prohibited payments during any period in which the plan sponsor of a plan is a debtor in a case under title 11, United States Code, or any similar Federal or State law.

(ii) *Unpredictable contingent event benefits and plan amendments increasing benefit liability*—(A) *In general.* If no presumptions under section 436(h) apply to a plan during a period and the plan's enrolled actuary has not yet issued a certification of the plan's adjusted funding target attainment percentage for the plan year, the limitations on unpredictable contingent event benefits under paragraph (b) of this section or plan amendments increasing benefit liability under paragraph (c) of this section during that period must be applied following the rules of paragraph (g)(5) of this section, based on the preceding year's certified adjusted funding target attainment percentage. Thus, if after application of those rules the plan would be treated as having an adjusted funding target attainment percentage below the applicable threshold under paragraph (b) or (c) of this section (taking into account the increase in the funding target attributable to the unpredictable contingent event benefits or the increase in liability attributable to the plan amendment), the unpredictable contingent event benefits are not permitted to be paid, and the plan amendment is not permitted to go into effect, unless the contribution described in paragraph (g)(5)(ii) of this section is made.

(B) *Recharacterization of contributions to avoid benefit limitations.* If, pursuant to paragraph (g)(3)(ii)(A) of this section, the plan sponsor makes contributions described in paragraph (g)(5)(ii) of this section to avoid application of the applicable benefit limitations, then, after the certification of the adjusted funding target attainment percentage for the current plan year is issued by the plan's enrolled actuary, those contributions are recharacterized as employer contributions under section 430 for the current plan year to the extent they exceed the amount necessary to avoid application of the applicable limitation under paragraph (b) or (c) of this section based on the certified percentage.

(4) *Periods after certification of adjusted funding target attainment percentage*—(i) *Plan must follow certified percentage*—(A) *In general.* The rules of paragraphs (g)(2) and (g)(3) of this section no longer apply for a plan year on and after the date the enrolled actuary for the plan issues a certification of the adjusted funding target attainment percentage of the plan for the current plan year, provided that the certification is issued before the first day of the 10th month of the plan year. Thus, for

example, the plan must provide that paragraph (d) of this section applies for distributions with annuity starting dates on and after the date of that certification using the certified adjusted funding target attainment percentage of the plan for the plan year. Similarly, the plan must provide that any prohibition on accruals under paragraph (e) of this section as a result of the enrolled actuary's certification that the adjusted funding target attainment percentage of the plan for the plan year is less than 60 percent is effective as of the date of the certification and that any prohibition on accruals ceases to be effective on the date the enrolled actuary issues a certification that the adjusted funding target attainment percentage of the plan for the plan year is at least 60 percent. In addition, in the case of a plan that has been issued a certification of the plan's adjusted funding target attainment percentage for a plan year by the plan's enrolled actuary, the plan sponsor must comply with the requirements of paragraphs (b) and (c) of this section for an unpredictable contingent event that occurs or a plan amendment that is effective on or after the date of the enrolled actuary's certification. Thus, the plan administrator must determine if the adjusted funding target attainment percentage is at or above the applicable threshold, taking into account the increase in the funding target that would be attributable to the unpredictable contingent event or plan amendment if the unpredictable contingent event benefits or the increase in liability attributable to the plan amendment were taken into account.

(B) *Application of rule for deemed election to reduce funding balances.* After the adjusted funding target attainment percentage for a plan year is certified by the plan's enrolled actuary, the deemed election to reduce funding balances under paragraph (a)(5) of this section must be reapplied based on the actual funding target for the year (provided the certification is issued before the first day of the 10th month of the plan year). This reapplication of the deemed election may require an additional reduction in funding balances if the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of the limitations under paragraph (d) or (e) of this section is greater than the amount that was reduced under paragraph (g)(2) or (g)(3) of this section.

(C) *Prior reductions continue to apply.* If the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of the benefit limitation is less than the amount that was reduced under paragraph (g)(2) or (g)(3) of this section, then the prior reduction continues to apply. Similarly, if the amount of the reduction in funding balances that is necessary to reach the applicable threshold to avoid the application of the corresponding benefit limitation exceeds the amount of the funding balances, then the prior reduction continues to apply and no further reduction under paragraph (a)(5) of this section is provided.

(ii) *Applicability to prior periods*—(A) *In general.* Except as provided in paragraph (g)(4)(ii)(B) of this section, the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect the application of the limitation under paragraph (b) of this section with respect to unpredictable contingent events that occur during the periods to which paragraphs (g)(2) and (g)(3) of this section apply. Except as provided in paragraph (g)(4)(ii)(B) of this section, the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect the application of the limitation under paragraph (c) of this section to a plan amendment that increases liability for benefits where the amendment is first effective during the periods to which paragraphs (g)(2) and (g)(3) apply. The enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect the application of the limitation under paragraph (d) of this section for distributions with annuity starting dates before the certification. Similarly, the enrolled actuary's certification of the adjusted funding target attainment percentage for the plan for the plan year does not affect the application of the limitation under paragraph (e) of this section prior to the date of that certification. See paragraph (a)(4) of this section for rules relating to the period of time after benefits cease to be limited.

(B) *Special rule for unpredictable contingent event benefits and plan amendments that increase liability.* If a plan does not pay benefits attributable to an unpredictable contingent event or plan amendment because of the application of paragraph (g)(5)(ii) of this section, the plan must provide for benefits that were not previously paid (or accrued) if such benefits would be permitted under the rules of section 436 based on the certified actual adjusted funding target attainment percentage, taking into account the increase in the funding target that would be attributable to the unpredictable contingent event benefits or increase in liability due to the plan amendment.

(5) *Additional rules regarding limitations on unpredictable contingent event benefits and certain plan amendments based on presumed adjusted funding target prior to certification*—(i) *Reduction in funding balances*—(A) *Mandatory reduction for collectively bargained plans.* During the period described in paragraph (g)(2) or (g)(3) of this section, the rules of paragraph (a)(5) of this section (relating to the deemed election to reduce the funding standard carryover balance and the prefunding balance) must be applied based on the presumed percentage. In order to determine the amount of the reduction in those balances that would apply to a collectively bargained plan during that period with respect to an unpredictable contingent event or a plan amendment that increases liability for benefits, the rules of paragraph (g)(2)(ii) of this section are applied, except that the presumed adjusted funding target is increased to take into account the benefits attributable to the unpredictable contingent event or the plan amendment. For this purpose, if no presumption applies under the rules of paragraph (h) of this section (for example, because the plan's actual adjusted funding target attainment percentage for the prior year was certified to be at least 80 percent), then that prior year's actual adjusted funding target attainment percentage is substituted for the presumed adjusted funding target attainment percentage for the plan year in determining the presumed adjusted funding target.

(B) *Optional reduction for plans that are not collectively bargained plans.* A plan sponsor of a plan that is not a collectively bargained plan (and, thus, is not required to reduce the funding standard account carryover balance and the prefunding balance under the rules of paragraph (a)(5) of this section) is permitted to reduce

those balances in order to increase the interim value of adjusted plan assets (as defined in paragraph (g)(2)(ii)(A) of this section) that is compared to the presumed adjusted funding target determined under this paragraph (g)(5)(i).

(ii) *Plans funded below the threshold.* If, after application of paragraph (g)(5)(i) of this section, the ratio of the interim value of adjusted plan assets (as defined in paragraph (g)(2)(ii)(A) of this section) to the presumed adjusted funding target determined under that paragraph is less than the applicable threshold under section 436(b) or 436(c), as applicable, then the plan is not permitted to provide any benefits attributable to the unpredictable contingent event or plan amendment unless the plan sponsor makes a contribution that would allow payment of unpredictable contingent event benefits or would permit a plan amendment increasing benefit liabilities to go into effect under the rules of paragraph (b)(2) or (c)(2) of this section.

(iii) *Plans funded at or above the threshold.* If, after application of paragraph (g)(5)(i) of this section, the ratio of the interim value of adjusted plan assets (as defined in paragraph (g)(2)(ii)(A) of this section) to the presumed adjusted funding target is greater than or equal to the applicable threshold under section 436(b) or 436(c), as applicable, then the plan is not permitted to limit the payment of unpredictable contingent event benefits described in paragraph (b) of this section nor is the plan permitted to restrict a plan amendment increasing benefit liability described in paragraph (c) of this section from becoming effective based on an expectation that the limitations under paragraph (b) or (c) of this section will apply to the plan once an actuarial certification is received.

(6) *Application to multiple events and amendments.* For purposes of this paragraph (g), if a plan is providing benefits with respect to one or more unpredictable contingent events occurring within the plan year or amendments taking effect within the plan year, then paragraphs (b) and (c) of this section are applied with respect to a subsequent unpredictable contingent event or amendment by treating the increase in the funding target attributable to the subsequent event or amendment as if it included the increases in the funding target attributable to all such earlier events or amendments.

(7) *Examples.* The following examples illustrate the application of this paragraph (g). Unless otherwise indicated, these examples are based on the following facts: each plan has a plan year that is the calendar year and a valuation date of January 1; the first effective plan year is 2008; the plan sponsor is not in bankruptcy; and no annuity purchases have been made from the plan. No plan is in at-risk status for the years discussed in the examples.

Example 1. (i) As of January 1, 2011, Plan A has assets of $3,300,000 and a prefunding balance of $300,000. Plan A has no funding standard carryover balance. Beginning on January 1, 2011, Plan A's AFTAP for 2011 is presumed to be 75%, under the rules of paragraph (h) of this section and based on the certified AFTAP for 2010.

(ii) Based on Plan A's presumed AFTAP of 75%, Plan A would be subject to the restriction on prohibited payments in paragraph (d)(3) of this section as of January 1, 2011. However, under the provisions of paragraph (a)(5) of this section, if the prefunding balance is large enough, Plan A's sponsor is deemed to elect to reduce the prefunding balance to the extent needed to avoid this restriction.

(iii) The amount needed to avoid the restriction in paragraph (d)(3) of this section is determined by comparing the presumed adjusted funding target for Plan A with the interim value of adjusted plan assets as of the valuation date. The interim value of plan assets for Plan A is $3,000,000 (that is, the asset value of $3,300,000 reduced by the prefunding balance of $300,000). The presumed adjusted funding target for Plan A is the interim value of the adjusted plan assets divided by the presumed AFTAP, or $4,000,000 (that is, $3,000,000 divided by 75%).

(iv) In order to avoid the restriction on prohibited payments in paragraph (d)(3) of this section, Plan A's presumed AFTAP must be increased to 80%. This requires an increase in Plan A's adjusted plan assets of $200,000 (that is, 80% of the presumed adjusted funding target of $4,000,000, minus the interim value of the adjusted plan assets of $3,000,000). Plan A's prefunding balance as of January 1, 2011, is reduced by $200,000 under the deemed election provisions of paragraph (a)(5) of this section. Accordingly, Plan A's prefunding balance is $100,000 (that is, $300,000 minus $200,000) and the interim value of adjusted plan assets is increased to $3,200,000 (that is, $3,300,000 minus the reduced prefunding balance of $100,000). Plan A must pay the full amount of the accelerated benefit distributions elected by participants with an annuity starting date of January 1, 2011, or later.

Example 2. [Reserved].

Example 3. (i) The facts are the same as in *Example 1*. On July 1, 2011, the enrolled actuary for Plan A calculates the actual adjusted funding target as $3,700,000 as of January 1, 2011. Therefore, the 2011 AFTAP would have been 81.08% without reducing the prefunding balance (that is, plan assets of $3,300,000 minus the prefunding balance of $300,000, divided by the adjusted funding target of $3,700,000), and Plan A would not have been subject to the restrictions under paragraph (d)(3) of this section.

(ii) However, paragraph (g)(4)(i)(C) of this section requires that any prior reductions in the prefunding or funding standard carryover balances continue to apply, and so Plan A's prefunding balance remains at the reduced amount of $100,000 as of January 1, 2011. The enrolled actuary certifies that the 2011 AFTAP is 86.49% (that is, plan assets of $3,300,000 reduced by the prefunding balance of $100,000, divided by the adjusted funding target of $3,700,000).

Example 4. (i) Plan B is a collectively bargained plan with assets of $2,500,000 and a prefunding balance of $150,000 as of January 1, 2011. Plan B has no funding standard carryover balance. Beginning on January 1, 2011, Plan B's AFTAP for 2011 is presumed to be 83% under the rules of paragraph (g)(3) of this section and based on the certified AFTAP for 2010.

(ii) On January 10, 2011, Plan B's sponsor amends the plan to increase benefits effective on February 1, 2011. The amendment would increase Plan B's funding target by $350,000. Under the rules of paragraph (g)(5) of this section, the presumed adjusted funding target is calculated, and then the presumed adjusted funding target is increased to take into account the benefits attributable to the plan amendment.

(iii) Plan B's interim value of adjusted plan assets as of the valuation date is $2,350,000 (that is, $2,500,000 minus the prefunding balance of $150,000). Prior to reflecting the amendment, Plan B's presumed adjusted funding target as of January 1, 2011, is $2,831,325, which is equal to the interim value of adjusted plan assets as of the valuation date of $2,350,000, divided by the presumed AFTAP of 83%. Increasing Plan B's presumed adjusted funding target by $350,000 to reflect the amendment results in a presumed adjusted funding target of $3,181,325 and a presumed AFTAP of 73.87% (that is, the interim value of adjusted plan assets as of the valuation date of $2,350,000 divided by the presumed adjusted funding target of $3,181,325).

(iv) Because Plan B's presumed AFTAP was over 80% prior to taking the amendment into account but less than 80% when the amendment is reflected, section 436(c) and paragraph (c) of this section prohibit the plan amendment from taking effect unless the adjusted plan assets are increased so that the presumed AFTAP (reflecting the increase due to the amendment) is increased to 80%. This would require an additional amount of $195,060 (that is, 80% of the presumed adjusted funding target of $3,181,325 less the interim value of adjusted plan assets of $2,350,000).

(v) Plan B's prefunding balance of $150,000 is not large enough for Plan B to avoid the restriction on plan amendments, and therefore the deemed election to reduce the prefunding balance under paragraph (a)(5) of this section does not apply and the amendment cannot take effect.

Example 5. (i) The facts are the same as in *Example 4*, except that Plan B's sponsor decides to make a contribution on February 1, 2011, to avoid the benefit limitation as provided in paragraph (f)(2) of this section. Pursuant to paragraph (f)(2)(i)(A)(*2*) of this section, Plan B's effective rate of interest for 2011 is treated as 5.25%.

(ii) The amount of the contribution as of January 1, 2011, needed to avoid the restriction on plan

amendments under paragraph (c) of this section is $195,060. However, because the contribution is not paid until February 1, 2011, the necessary contribution amount must be adjusted to reflect interest that would otherwise have accrued between the valuation date and the date of the contribution, at Plan B's effective rate of interest for the 2011 plan year. The amount of the required contribution after adjustment is $195,894, determined as $195,060 increased for one month of compound interest at an effective annual interest rate of 5.25%.

(iii) As of April 1, 2011, the enrolled actuary for the plan has not certified the 2011 AFTAP. Therefore, beginning April 1, 2011, Plan A's presumed AFTAP is presumed to be 73%, 10 percentage points lower than the 2010 AFTAP, in accordance with paragraph (h)(2) of this section. However, paragraph (g)(2)(ii)(B) of this section does not require reapplication of the deemed election if necessary to avoid the application of benefit restrictions under paragraph (c) of this section. Therefore, since the effective date of the plan amendment occurred prior to April 1, 2011, no additional reduction in the prefunding balance is required and no additional contribution is required for the plan amendment to remain in effect.

(iv) On July 1, 2011, the enrolled actuary for the plan calculates the actual adjusted funding target, prior to taking the plan amendment into account, as $2,700,000 and certifies the actual AFTAP for 2011 (prior to taking the amendment into account) as 87.04% (that is, adjusted assets of $2,350,000 divided by the adjusted funding target of $2,700,000). Reflecting the $350,000 increase in funding target due to the plan amendment would increase the adjusted funding target to $3,050,000 and would decrease Plan B's AFTAP to 77.05%.

(v) Based on the certified AFTAP, the amount necessary to avoid the benefit restriction under paragraph (c) of this section is $90,000 (that is, 80% of the adjusted funding target reflecting the plan amendment (or $3,050,000), minus the adjusted value of plan assets of $2,350,000). This amount must be adjusted for interest between the valuation date and the date the contribution was made using the effective interest rate for Plan B. Therefore, the amount required on the payment date of February 1, 2011, is $90,385 (that is, $90,000 adjusted for compound interest for one month at Plan B's effective interest rate of 5.25% per year).

(vi) Under paragraph (g)(3)(ii)(B) of this section, the contribution made under paragraph (g)(5)(ii) of this section is recharacterized as an employer contribution under section 430 to the extent that it exceeds the amount necessary to avoid application of the restriction on plan amendments under paragraph (c) of this section. Therefore, $105,509 (that is, the $195,894 actual contribution paid on February 1, 2011, minus the $90,385 required contribution based on the actual certified AFTAP) is recharacterized as an employer contribution under section 430 for the 2011 plan year. As such, it may be applied toward the minimum required contribution for 2011, or the plan sponsor can elect to credit the contribution to Plan B's prefunding balance to the extent that the contributions for the 2011 plan year exceed the minimum required contribution.

Example 6. (i) The facts are the same as in *Example 5*, except that on July 1, 2011, the enrolled actuary for Plan B calculates the actual adjusted funding target (before reflecting the plan amendment) as $3,000,000 and certifies the actual AFTAP as 78.33% prior to reflecting the plan amendment (that is, adjusted plan assets of $2,350,000 divided by the actual adjusted funding target of $3,000,000). Based on the provisions of paragraph (c) of this section, because the AFTAP prior to reflecting the amendment is less than 80%, the contribution required to avoid the restriction on plan amendments would have been the amount equal to the increase in funding target due to the plan amendment, or $350,000.

(ii) However, according to paragraph (g)(4)(ii)(A) of this section, the enrolled actuary's certification of the 2011 AFTAP does not affect the application of the limitation under paragraph (c) of this section regardless of the extent to which the certified percentage varies from the presumed percentage, because the amendment to Plan B was effective prior to the date of the certification. Therefore, it is not necessary for Plan B's sponsor to contribute an additional amount in order for the plan amendment to remain in effect.

(h) *Presumed underfunding for purposes of benefit limitations*—(1) *Presumption of continued underfunding*—(i) *In general.* This paragraph (h)(1) applies to a plan for which a limitation under paragraph (b), (c), (d), or (e) of this section applied to the plan on the last day of the plan year preceding the current plan year. If this paragraph (h)(1) applies to a plan, the first day of the plan year is a section 436 measurement date and the presumed adjusted funding target attainment percentage for the plan is the percentage under paragraph (h)(1)(ii) or (iii) of this section, whichever applies to the plan, beginning on that first day until it is changed under this paragraph (h).

(ii) *Rule where preceding year certification issued during preceding year.* In any case in which the plan's enrolled actuary has issued a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year preceding the current year before the first day of the current year, the adjusted funding target attainment percentage of the plan for the current plan year is presumed to be equal to the preceding year's actual adjusted funding target attainment percentage until the plan's enrolled actuary issues a certification of the adjusted funding target attainment percentage of the plan for the current plan year under paragraph (h)(4) of this section or until changed under paragraph (h)(2) or (h)(3) of this section.

(iii) *No certification for preceding year issued during preceding year*—(A) *Deemed percentage under 60 percent.* In any case in which the plan's enrolled actuary has not issued a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage of the plan for the plan year preceding the current year during that prior plan year, the adjusted funding target attainment percentage of the plan for the current plan year is presumed to be less than 60 percent until changed under paragraph (h)(1)(iii)(B) or (h)(2)(iii) of this section or where the plan's enrolled actuary issues the certification of the adjusted funding target attainment percentage for the current year under paragraph (h)(4) of this section.

(B) *Enrolled actuary's certification in first 3 months of following year.* In any case in which the plan's enrolled actuary has issued the certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage of the plan for the plan year preceding the current year on or after the first day of the current year but before the first day of the 4th month of that year, the date of that prior year certification is a new section 436 measurement date for the plan year. In such a case, until it is changed by a certification of the current year's adjusted funding target attainment percentage under paragraph (h)(4) of this section or otherwise changed under paragraph (h)(2) or (h)(3) of this section, the presumed percentage for the current year beginning on the date of certification is equal to the certified percentage for the preceding year.

(2) *Presumption of underfunding after first day of 4th month for nearly underfunded plans*—(i) *In general.* This paragraph (h)(2) applies to a plan for which the actual adjusted funding target attainment percentage for the plan year preceding the current plan year was certified for that prior plan year to be at least 60 percent but less than 70 percent, or was certified for that prior plan year to be at least 80 percent but less than 90 percent (or, if that prior plan year is the pre-effective plan year, was certified to be less than 90 percent), and where the enrolled actuary for the plan has not issued a certification of the adjusted funding target attainment percentage for the plan year by the first day of the 4th month of the plan year. If this paragraph (h)(2) applies to a plan, the presumed adjusted funding target attainment

percentage for the plan is the percentage under paragraph (h)(2)(ii) or (iii) of this section, as applicable.

(ii) *Presumed adjusted funding target attainment percentage.* If this paragraph (h)(2) applies to a plan, and the date of the enrolled actuary's certification under paragraph (h)(4) of this section for the plan year preceding the current year occurred before the first day of the 4th month of the current plan year, then, commencing on the first day of the 4th month of the current plan year and continuing until the earlier of the date the enrolled actuary issues a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year or the first day of the 10th month of the plan year as described in paragraph (h)(3) of this section—

(A) The adjusted funding target attainment percentage of the plan as of the valuation date for the plan year is presumed to be equal to 10 percentage points less than the actual adjusted funding target attainment percentage of the plan for the preceding plan year; and

(B) The first day of the 4th month of the plan year is treated as a section 436 measurement date.

(iii) *Certification for prior year.* If this paragraph (h)(2) applies to a plan, and the date of the enrolled actuary's certification under paragraph (h)(4) of this section of the actual adjusted funding target attainment percentage for the plan year preceding the current year occurs on or after the first day of the 4th month of the current plan year, then, commencing on the date of that prior year certification and continuing until the earlier of the date the enrolled actuary issues a certification under paragraph (h)(4) of this section of the adjusted funding target attainment percentage for the plan year or the first day of the 10th month of the plan year as described in paragraph (h)(3) of this section—

(A) The adjusted funding target attainment percentage of the plan as of the valuation date for the plan year is presumed to be equal to 10 percentage points less than the actual adjusted funding target attainment percentage of the plan for the preceding plan year; and

(B) The date of the prior year certification is treated as a section 436 measurement date.

(3) *Presumption of underfunding on and after first day of 10th month*—(i) *Section 436 measurement date.* In any case in which no certification of the specific adjusted funding target attainment percentage for the current plan year under paragraph (h)(4) of this section is made with respect to the plan before the first day of the 10th month of the plan year, that first day is treated as a section 436 measurement date.

(ii) *Presumed percentage under 60 percent.* In any case in which no certification of the specific adjusted funding target attainment percentage for the current plan year under paragraph (h)(4) of this section is made with respect to the plan before the first day of the 10th month of the plan year, the plan's adjusted funding target attainment percentage is presumed to be less than 60 percent beginning on that date and continuing through the remainder of the plan year.

(4) *Certification of adjusted funding target attainment percentage*—(i) *Rules generally applicable to certifications*—(A) *In general.* The enrolled actuary's certification referred to in this section must be made in writing, must be provided to the plan administrator, and, except as provided in paragraph (h)(4)(ii) of this section, must certify the plan's adjusted funding target attainment percentage for the plan year (including setting forth the aggregate amount of annuity purchases taken into account under paragraph (j)(3)(ii) of this section).

(B) *Determination of plan assets.* For purposes of making any determination of the adjusted funding target attainment percentage under this section, the determination is not permitted to take into account assets that have not been contributed to the plan by the certification date. For example, the enrolled actuary's certification of the adjusted funding target attainment percentage for a plan year cannot take into account contributions that are expected to be made after the certification date. Notwithstanding the foregoing, for plan years beginning before January 1, 2009, the enrolled actuary's certification of the adjusted funding target attainment percentage is permitted to take into account employer contributions for the prior plan year that are reasonably expected to be made for that prior plan year but have not been contributed by the date of the enrolled actuary's certification. See paragraph (h)(4)(iii) of this section for rules relating to changes in the certified percentage.

(ii) *Special rules for certification within range*—(A) *In general.* Under this paragraph (h)(4)(ii), the plan's enrolled actuary is permitted to certify during the first nine months of a plan year that the plan's adjusted funding target attainment percentage for that plan year either is 60 percent or higher (but is less than 80 percent), is 80 percent or higher, or is 100 percent or higher. If the enrolled actuary has issued such a range certification for a plan year and the enrolled actuary subsequently issues a certification of the specific adjusted funding target attainment percentage for the plan before the first day of the 10th month of that plan year, the certification of the specific adjusted funding target attainment percentage is treated as a change in the applicable percentage to which paragraph (h)(4)(iii) of this section applies. If the enrolled actuary has issued a range certification for a plan year but no specific certification of the adjusted funding target attainment percentage of the plan for the plan year is issued by the plan's enrolled actuary before the first day of the 10th month of that plan year, then the rules of paragraph (h)(3) of this section apply and the change in the applicable percentage to under 60 percent on that date is treated as a change in the applicable percentage which is subject to the rules of paragraph (h)(4)(iii) of this section.

(B) *Effect of range certification*—(*1*) *Before certification of specific percentage.* If a plan's enrolled actuary issues a range certification pursuant to this paragraph (h)(4)(ii), then, for all purposes under this section (for example, applying the limitations of sections 436(b) and (c), making contributions described in sections 436(b)(2), 436(c)(2), and 436(e)(2), and the mandatory reduction of funding balances under paragraph (a)(5) of this section), the plan is treated as having a certified percentage at the smallest value within the applicable range.

(*2*) *On and after certification of specific percentage.* Once the certification of the specific adjusted funding target attainment percentage is issued by the plan's enrolled actuary (before the first day of the 10th month of the plan year), that certified percentage applies for all purposes of this

section on and after the date of that certification. If the plan sponsor made section 436 contributions to avoid application of a benefit limitation during the period a range certification was in effect, those section 436 contributions will be recharacterized as employer contributions under section 430 to the extent the contributions exceed the amount necessary to avoid application of a limitation based on the specific adjusted funding target attainment percentage as certified by the plan's enrolled actuary before the first day of the 10th month of the plan year.

(iii) *Change of certified percentage*—(A) *Application of new percentage.* If the enrolled actuary for the plan provides a certification of the adjusted funding target attainment percentage of the plan for the plan year under this paragraph (h)(4) (including a range certification) and that certified percentage is superseded by a subsequent determination of the adjusted funding target attainment percentage for that plan year, that later percentage must be applied.

(B) *Determination of materiality*—*(1) In general.* With respect to the effect of that subsequent determination of the adjusted funding target attainment percentage on the plan for the period during which the plan's operation was based on the prior percentage, a determination must be made whether the change in the applicable percentage is a material change or an immaterial change.

(2) Definition of material change. For this purpose, there is a material change in a plan's certified adjusted funding target attainment percentage if plan operations with respect to benefits that are addressed by section 436, taking into account any actual contributions and elections under section 430(f) made by the plan sponsor based on the prior certified percentage, would have been different based on the subsequent determination of the plan's adjusted funding target attainment percentage for the plan year. However, if the difference between the adjusted funding target attainment percentage for a plan year and the later revised determination of that percentage is the result of additional contributions for the preceding year that are made by the plan sponsor after the date of the enrolled actuary's certification or results from the plan sponsor's election to reduce the prefunding balance or funding standard carryover balance after the date of the certification, such change is not treated as a material change.

(3) Definition of immaterial change. An immaterial change is any change in an adjusted funding target attainment percentage for a plan year that is not a material change.

(C) *Effect of change in percentage*—*(1) Material change.* In the case of a material change where the plan was operated in accordance with the prior certification of the adjusted funding target attainment percentage for the plan year, the plan will not have satisfied the requirements of section 401(a)(29) and section 436. In the case of a material change where the plan was operated in accordance with the subsequent certification of the adjusted funding target attainment percentage during the period of time the prior certification applied, the plan will not have been operated in accordance with its terms. In addition, in the case of a material change, the rules requiring application of a presumed adjusted funding target attainment percentage under paragraphs (h)(1) through (h)(3) of this section continue to apply from and after the date of the prior certification until the date of the subsequent certification.

(2) Effect of immaterial change. If the enrolled actuary for a plan provides a certification of the adjusted funding target attainment percentage of the plan for the plan year under this paragraph (h)(4) and that certified percentage is superseded by a subsequent determination of the adjusted funding target attainment percentage for that plan year that does not result in a material change under paragraph (h)(4)(iii)(B) of this section, the revised percentage does not change the inapplicability of the presumptions under paragraphs (h)(1), (2), and (3) of this section prior to the date of the later certification.

(5) *Application to plan with valuation date after first day of plan year.* [Reserved].

(6) *Examples of application of paragraphs (h)(1), (h)(2), and (h)(3) of this section.* The following examples illustrate the application of paragraphs (h)(1), (h)(2), and (h)(3) of this section. Unless otherwise indicated, the examples in this section are based on the information in this paragraph. Each plan is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The first effective plan year is 2008. The plan does not have a funding standard carryover balance or a prefunding balance as of any of the dates mentioned, and the plan sponsor does not elect to utilize any of the methods in paragraph (f) of this section to avoid applicable benefit restrictions. No range certification under paragraph (h)(4) of this section has been issued. The plan sponsor is not in bankruptcy.

Example 1. (i) On July 15, 2010, the adjusted funding target attainment percentage ("AFTAP") for Plan T is certified to be 65%. Based on this AFTAP, Plan T is subject to the restriction on prohibited payments in paragraph (d)(3) of this section for the remainder of 2010.

(ii) Beginning January 1, 2011, Plan T's AFTAP for 2011 is presumed to be equal to the AFTAP for 2010, or 65%, under the provisions of paragraph (h)(1)(ii) of this section. Accordingly, the restriction on accelerated benefit distributions in paragraph (d)(3) of this section continues to apply.

(iii) On March 1, 2011, the enrolled actuary for the plan certifies that the actual AFTAP for 2011 is 80%. Therefore, beginning March 1, 2011, Plan T is no longer subject to the restriction under paragraph (d)(3) of this section, and so Plan T resumes paying the full amount of any accelerated benefit distributions elected by participants with an annuity starting date of March 1, 2011, or later.

Example 2. (i) The facts are the same as in *Example 1*, except that the enrolled actuary for the plan does not certify the AFTAP for 2011 until June 1, 2011. Accordingly, Plan T's AFTAP for 2011 is presumed to be equal to the AFTAP for 2010 of 65% from January 1, 2011, through March 31, 2011, and Plan T is subject to the restriction on accelerated benefit distributions under paragraph (d)(3) of this section during this period.

(ii) Beginning April 1, 2011, the provisions of paragraph (h)(2)(ii) of this section apply because the enrolled actuary for the plan still has not certified the actual AFTAP as of January 1, 2011. Under the provisions of paragraph (h)(2)(ii) of this section, the AFTAP for Plan T is presumed to be 10 percentage points lower, or 55%, beginning April 1, 2011. Accordingly, Plan T is now subject to the restriction in paragraph (d)(1) of this section, and so cannot pay any accelerated benefit distributions otherwise payable to plan participants who have annuity starting dates on or after April 1, 2011.

(iii) On June 1, 2011, the enrolled actuary for the plan certifies that the AFTAP for 2011 for Plan T is 66%. Accordingly, Plan T is no longer subject to the restriction under paragraph (d)(1) of this section, but it is subject to the restriction under paragraph (d)(3) of this section.

(iv) Since Plan T is no longer subject to the restriction on payment of accelerated benefit distributions under paragraph (d)(1) of this section, Plan T must resume paying the accelerated benefit distributions, as restricted under paragraph (d)(3) of this section, for participants who elect benefits in accelerated forms of payment and who have an annuity starting date of June 1, 2011, or later.

Example 3. (i) The facts are the same as in *Example 1*, except that the enrolled actuary for the plan does not certify the 2011 AFTAP until November 15, 2011. Beginning October 1, 2011, Plan T is conclusively presumed to have an AFTAP of less than 60%, in accordance with the provisions of paragraph (h)(3) of this section. Accordingly, Plan T is subject to the restriction in paragraph (d)(1) of this section, and cannot pay any accelerated benefit distributions to participants whose annuity starting date occurs on or after October 1, 2011.

(ii) On November 15, 2011, the enrolled actuary for the plan certifies that the AFTAP for 2011 is 72%. However, because the certification occurred after October 1, 2011, the certification does not constitute a new section 436 measurement date, and Plan T continues to be subject to the restrictions on accelerated benefit distributions and benefit accruals under paragraphs (d)(1) and (e) of this section.

(iii) Beginning January 1, 2012, the 2012 AFTAP for Plan T is presumed to be equal to the 2011 AFTAP of 72%. Because the presumed 2012 AFTAP is between 70% and 80% and, therefore, paragraph (h)(2) of this section (which provides for a 10 percentage point reduction in a plan's AFTAP in certain cases) will not apply, the presumed AFTAP will remain at 72% until the plan's enrolled actuary certifies the AFTAP for 2012 or until paragraph (h)(3) of this section applies on the first day of the 10th month of the plan year. Because the presumed AFTAP is 72%, Plan T is no longer subject to the restrictions on accelerated benefit distributions under paragraph (d)(1) of this section, and Plan T must resume paying accelerated benefit distributions, as restricted under paragraph (d)(3) of this section, that are elected by participants with annuity starting dates on or after January 1, 2012. Similarly, Plan T is no longer subject to the restriction on benefit accruals under paragraph (e) of this section, and benefit accruals resume under Plan T beginning January 1, 2012, unless Plan T provides otherwise.

Example 4. (i) The facts are the same as in *Example 3*, except that the enrolled actuary for the plan does not issue a certification of the AFTAP for 2011 for Plan T until February 1, 2012.

(ii) Beginning on January 1, 2012, the presumptions in paragraph (h)(1)(iii) of this section apply for the 2012 plan year. Because the enrolled actuary for the plan has not certified the AFTAP for 2011, the presumed AFTAP as of October 1, 2011, continues to apply for the period beginning January 1, 2012. Therefore, the AFTAP as of January 1, 2012, is presumed to be less than 60%, and Plan T continues to be subject to the restriction on accelerated benefit distributions in paragraph (d)(1) of this section and the restriction on benefit accruals under paragraph (e) of this section.

(iii) On February 1, 2012, the enrolled actuary for the plan certifies that the AFTAP for 2011 for Plan T is 65%. Because the enrolled actuary for the plan has not issued a certification of the AFTAP for 2012, the provisions of paragraph (h)(1)(iii)(B) of this section apply. Accordingly, the certification date for the 2011 AFTAP (February 1, 2012) is a section 436 measurement date and 65% is the presumed AFTAP for 2012 beginning on that date.

(iv) Because the presumed AFTAP is over 60% but less than 80%, the full restriction on accelerated benefit distributions under paragraph (d)(1) of this section no longer applies; however the partial restriction on accelerated benefit distributions under paragraph (d)(3) of this section applies beginning on February 1, 2012. Therefore, Plan T must pay a portion of accelerated benefit distributions elected by participants with annuity starting dates on or after February 1, 2012. Furthermore, based on the presumed AFTAP of 65%, the restriction on benefit accruals under paragraph (e) of this section no longer applies, and unless Plan T provides otherwise, benefit accruals will resume as of February 1, 2012.

Example 5. (i) The facts are the same as in *Example 3*, except that the enrolled actuary for the plan does not issue a certification of the actual AFTAP for Plan T as of January 1, 2011, until May 1, 2012.

(ii) Beginning on January 1, 2012, the presumptions in paragraph (h)(1)(iii) of this section apply for the 2012 plan year. Because the enrolled actuary for the plan has not certified the actual AFTAP as of January 1, 2011, the presumed AFTAP as of October 1, 2011, continues to apply for the period beginning January 1, 2012. Therefore, the AFTAP as of January 1, 2012, is presumed to be less than 60%, and Plan T continues to be subject to the restriction on accelerated benefit distributions in paragraph (d)(1) of this section and the restriction on benefit accruals under paragraph (e) of this section.

(iii) Since the enrolled actuary for the plan has not issued a certification of the actual AFTAP as of January 1, 2011, the rules of paragraph (h)(1)(iii) of this section apply beginning April 1, 2012, and the AFTAP is presumed to remain less than 60%. Plan T continues to be subject to the restriction on accelerated benefit distributions and benefit accruals under paragraphs (d)(1) and (e) of this section.

(iv) On May 1, 2012, the enrolled actuary for the plan certifies that the actual AFTAP for 2011 for Plan T is 65%. Because the enrolled actuary for the plan has not issued a certification of the actual AFTAP as of January 1, 2012, the provisions of paragraph (h)(2)(iii) of this section apply. Accordingly, on May 1, 2012, the 2012 AFTAP is presumed to be 10 percentage points less than the 2011 AFTAP, or 55%, so that the restrictions under paragraphs (d) and (e) of this section continue to apply.

Example 6. (i) The enrolled actuary for Plan V certifies the plan's AFTAP for 2010 to be 69%. Based on this AFTAP, Plan V is subject to the restriction in paragraph (d)(3) of this section, and can only pay a portion (generally 50%) of accelerated benefit distributions otherwise due to plan participants who commence benefits while the restriction is in effect. The enrolled actuary for the plan does not issue a certification of the AFTAP for 2011 until June 1, 2011.

(ii) Beginning January 1, 2011, Plan V's 2011 AFTAP is presumed to be equal to the 2010 AFTAP, or 69%, under the provisions of paragraph (h)(1)(ii) of this section. Accordingly, the restriction on accelerated benefit distributions in paragraph (d)(3) of this section continues to apply from January 1, 2011, through March 31, 2011, and Plan T may only pay a portion of accelerated benefit distributions otherwise due to participants who commence benefit payments during this period.

(iii) Beginning April 1, 2011, the provisions of paragraph (h)(2)(ii) of this section apply. Under those provisions, the AFTAP beginning April 1, 2011, is presumed to be 10 percentage points lower than the presumed 2011 AFTAP, or 59%. Because Plan V's presumed AFTAP for 2011 is less than 60%, the restriction on the payment of accelerated benefit distributions under paragraph (d)(1) of this section and the restriction on benefit accruals under paragraph (e) of this section apply. Accordingly, Plan V cannot pay any accelerated benefit distributions to participants with an annuity starting date on or after April 1, 2011, and benefit accruals cease as of March 31, 2011.

(iv) On June 1, 2011, Plan V's enrolled actuary certifies that the plan's AFTAP for 2011 is 71%. Therefore, the restrictions on accelerated benefit distributions and benefit accruals in paragraphs (d)(1) and (e) of this section no longer apply, but the partial restriction on benefit payments in paragraph (d)(3) of this section does apply. Accordingly, Plan V begins paying a portion of the accelerated benefit distributions elected by participants with an annuity starting date on or after June 1, 2011, and benefit accruals previously restricted under paragraph (e) of this section resume effective June 1, 2011, unless Plan V provides otherwise.

(v) Participants who were not able to elect an accelerated form of payment during the period from April 1, 2011, through May 31, 2011, would be able to elect a new annuity starting date with a partial distribution of accelerated benefits effective June 1, 2011, if Plan V contained a preexisting provision permitting such an election after the restriction in paragraph (d)(1) of this section no longer applies. This is permitted because, under paragraph (a)(4)(ii)(A) of this section, a preexisting provision of this type is not considered a plan amendment and is therefore not subject to the plan amendment restriction in paragraph (c) of this section even though Plan V's AFTAP for 2011 is less than 80%.

(vi) Benefit accruals for the period beginning April 1, 2011, through May 31, 2011, would be automatically restored if Plan V contained a preexisting provision to retroactively restore benefit accruals restricted under paragraph (e) of this section after the restriction no longer applies. This is permitted because under paragraph (a)(4)(ii)(A) of this section, a preexisting provision of this type is not considered to be a plan amendment and is therefore not subject to the plan amendment restriction in paragraph (c) of this section even though Plan V's AFTAP for 2011 is less than 80%, because the period of the restriction did not exceed 12 months.

(7) *Examples of application of paragraph (h)(4) of this section.* The following examples illustrate the application of paragraph (h)(4) of this section:

Example 1. (i) Plan Y is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. Plan Y does not have a funding standard carryover balance or a prefunding balance. Plan Y's sponsor is not in bankruptcy. In June of 2010, the actual AFTAP for 2010 for Plan Y is certified as 65%. On the last day of the 2010 plan year, Plan Y is subject to the restrictions in paragraph (d)(3) of this section.

(ii) The enrolled actuary for the plan issues a range certification on March 21, 2011, certifying that the AFTAP for 2011 is at least 60% and less than 80%. Because the certification was issued before the first day of the 4th month of the plan year, the 10 percentage point reduction in the presumed AFTAP

under paragraph (h)(2) of this section does not apply. In addition, because the enrolled actuary for the plan has certified that the AFTAP is within this range, Plan Y is not subject to the full restriction on accelerated benefit payments in paragraph (d)(1) of this section or the restriction on benefit accruals under paragraph (e) of this section.

(iii) On August 1, 2011, the enrolled actuary for the plan certifies that the actual AFTAP as of January 1, 2011, is 75.86%. This AFTAP falls within the previously certified range. Thus, the change is immaterial under paragraph (h)(4)(iii) of this section and the new certification does not change the applicability or inapplicability of the restrictions in this section.

Example 2. (i) The facts are the same as in *Example 1*, except that the plan sponsor makes an additional contribution for the 2010 plan year on September 1, 2011, that is not added to the prefunding balance. Reflecting this contribution, the enrolled actuary for the plan issues a revised certification stating that the AFTAP for 2011 is 81%, and Plan Y is no longer subject to the restriction on accelerated benefit payments under paragraph (d)(3) of this section on that date.

(ii) Although the revised certification changes the applicability of the restriction under paragraph (d)(3) of this section, the change not a material change under paragraph (h)(4)(iii)(B)(*2*) of this section because it changed only because of additional contributions for the preceding year made by the plan sponsor after the date of the enrolled actuary's initial certification.

(i) [Reserved].

(j) *Definitions.* For purposes of this section—

(1) *Funding target.* For purposes of section 436, the *funding target* means the funding target under section 430(d) or 430(i), as applicable to the plan for the plan year.

(2) *Funding target attainment percentage*—(i) *In general.* For purposes of section 436, the *funding target attainment percentage* for any plan year is the fraction (expressed as a percentage), the numerator of which is the value of net plan assets for the plan year, and the denominator of which is the plan's funding target for the plan year (but determined without regard to the at-risk rules under section 430(i) even in the case of a plan that is in at-risk status). For this purpose, pursuant to section 430(f)(4), the value of net plan assets for the plan year is generally determined by subtracting the plan's funding standard carryover balance and prefunding balance (if any) for the plan year from the value of plan assets. A plan with a value of net plan assets for a plan year of zero is treated as having a funding target attainment percentage of zero, regardless of the amount of the plan's funding target.

(ii) *Application to plans that are fully funded without regard to subtraction of funding balances from plan assets*—(A) *In general.* If the funding target attainment percentage for a plan year, determined without regard to the section 430(f)(4) subtraction of the funding standard carryover balance and the prefunding balance from the value of plan assets, would be 100 percent or more, then, solely for purposes of section 436 and this section (but not section 430(d)), the value of net plan assets used in the determination of the funding target attainment percentage described in this paragraph (j)(2) (and the adjusted funding target attainment percentage described in paragraph (j)(3) of this section) is determined without regard to any subtraction of funding balances under section 430(f)(4).

(B) *Transition rule.* Paragraph (j)(2)(ii)(A) of this section is applied to plan years beginning after 2007 and before 2011 by substituting for "100 percent" the applicable percentage determined in accordance with the following table:

In the case of a plan year beginning in calendar year:	The applicable percentage is:
2008	92
2009	94
2010	96

(C) *Limitation.* Paragraph (j)(2)(ii)(B) of this section does not apply with respect to any plan year after 2008 unless the funding target attainment percentage (determined without regard to the section 430(f)(4) subtraction of the funding standard carryover balance and the prefunding balance from the value of plan assets) of the plan for each preceding plan year (after 2007) was not less than the applicable percentage with respect to such preceding plan year determined under paragraph (j)(2)(ii)(B) of this section.

(iii) *Special rules for first effective plan year*—(A) *In general.* In the case of the plan's first effective plan year, the funding target attainment percentage under section 436 for the plan's pre-effective plan year is determined as the fraction (expressed as a percentage), the numerator of which is the net plan assets determined under paragraph (j)(2)(iii)(B) of this section, and the denominator of which is the plan's current liability determined pursuant to section 412(l)(7) on the valuation date for the plan's pre-effective plan year.

(B) *General determination of value of net plan assets*—(*1*) *In general.* The value of net plan assets for purposes of this paragraph (j)(2)(iii) is determined under section 412(c)(2) as in effect for the plan's pre-effective plan year, except that the value of plan assets prior to subtracting the plan's funding standard account credit balance described in paragraph (j)(2)(iii)(B)(*2*) of this section can neither be less than 90 percent of the fair market value of plan assets nor greater than 110 percent of the fair market value of plan assets on the valuation date for that plan year.

(*2*) *Subtraction of credit balance.* If a plan has a funding standard account credit balance as of the valuation date for the plan's pre-effective plan year, that balance is subtracted from the net asset value described in paragraph (j)(2)(iii)(B)(*1*) of this section as of that valuation date. However, the subtraction does not apply if the value of plan assets determined in paragraph (j)(2)(iii)(B)(*1*) of this section is greater than or equal to 90 percent of the plan's current liability as of the valuation date for the plan determined under paragraph (j)(2)(iii)(A) of this section.

(*3*) *Effect of funding standard carryover balance reduction for first effective plan year.* Notwithstanding paragraph (j)(2)(iii)(B)(*2*) of this section, if, for the first effective plan year, the employer has made an election to reduce some or all of the funding standard carryover balance as

of the first day of that year in accordance with §1.430(f)–1(e), then the present value (determined as of the valuation date for the pre-effective plan year using the valuation interest rate for that pre-effective plan year) of the amount so reduced is not treated as part of the funding standard account credit balance when that balance is subtracted from the asset value under paragraph (j)(2)(iii)(B)(*2*) of this section.

(3) *Adjusted funding target attainment percentage*—(i) *In general*. The *adjusted funding target attainment percentage* for any plan year is the fraction (expressed as a percentage), the numerator of which is the adjusted plan assets described in paragraph (j)(3)(ii) of this section and the denominator of which is the adjusted funding target described in paragraph (j)(3)(iii) of this section.

(ii) *Adjusted plan assets*. The adjusted plan assets equals the net plan assets (determined under paragraph (j)(2) of this section), increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years.

(iii) *Adjusted funding target*—(A) *In general*. The adjusted funding target equals the funding target for the plan year (determined in accordance with paragraph (j)(1) of this section but without regard to the at-risk rules under section 430(i)), increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years.

(B) *Special rule for first effective plan year*. In the case of the plan's first effective plan year, for purposes of determining the adjusted funding target attainment percentage for the pre-effective plan year, the adjusted funding target is equal to the current liability determined pursuant to section 412(l)(7) as of the plan's valuation date for the pre-effective plan year, increased by the aggregate amount of purchases of annuities for employees other than highly compensated employees (as defined in section 414(q)) which were made by the plan during the preceding 2 plan years.

(iv) *Special rule where current liability not certified for pre-effective plan year*. In any case in which the plan's enrolled actuary has not issued a certification under paragraph (h)(4)(i) of this section of the adjusted funding target attainment percentage of the plan for the pre-effective plan year, the adjusted funding target attainment percentage of the plan for the first effective plan year is presumed to be less than 60 percent until the adjusted funding target attainment percentage of the plan for the pre-effective plan year has been certified. The preceding sentence applies for purposes of paragraphs (b) and (c) of this section at the beginning of the first effective plan year and applies for purposes of paragraphs (d) and (e) of this section as of the first day of the 4th month of the first effective plan year. See paragraph (h) of this section for rules that apply after the adjusted funding target attainment percentage for the plan has been certified for either the pre-effective plan year or the first effective plan year.

(4) *Section 436 measurement date*. The section 436 measurement date is the date that is used to stop or start the application of the limitations of sections 436(d) and 436(e), and is also used for calculations with respect to applying the limitations of paragraphs (b) and (c) of this section. See paragraph (h) of this section regarding section 436 measurement dates that result from application of the presumptions under that paragraph (h) of this section.

(5) *Examples*. The following examples illustrate the application of this paragraph (j):

Example 1. (i) Plan S is a non-collectively bargained defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The first effective plan year is 2008.

(ii) As of January 1, 2008, Plan S has a value of plan assets (equal to the market value of assets) of $2,100,000 and a funding standard carryover balance of $200,000. During 2006, assets from Plan S were used to purchase a total of $100,000 in annuities for employees other than highly compensated employees. No annuities were purchased during 2007. On May 1, 2008, the enrolled actuary for the plan determines that the funding target as of January 1, 2008, is $2,500,000.

(iii) The adjusted value of assets for Plan S as of January 1, 2008, is $2,000,000 (that is, plan assets of $2,100,000 plus annuity purchases of $100,000 minus the funding standard carryover balance of $200,000). The adjusted funding target is $2,600,000 (that is, the funding target of $2,500,000, increased by the annuity purchases of $100,000).

(iv) Based on the above adjusted plan assets and adjusted funding target, the AFTAP as of January 1, 2008, would be 76.92%. Since the AFTAP is less than 80% but is at least 60%, Plan S is subject to the restrictions in paragraph (d)(3) of this section.

Example 2. (i) The facts are the same as in *Example 1*, except that it is reasonable to expect that the plan sponsor will make a contribution of $80,000 to Plan S for the 2007 plan year by September 15, 2008. This amount is in excess of the minimum required contribution for 2007. The plan sponsor elects to reduce the funding standard carryover balance by $80,000.

(ii) Because it is reasonable to expect that the $80,000 will be contributed by the plan sponsor, that amount is taken into account when the enrolled actuary certifies the 2008 AFTAP under the special rule in paragraph (h)(4)(i)(B) of this section for plan years beginning before 2009. Accordingly, the enrolled actuary for the plan certifies the 2008 AFTAP as 80% (that is, adjusted plan assets of $2,080,000, reflecting the $80,000 in contributions receivable, divided by the adjusted funding target of $2,600,000).

(iii) The ability to take contributions into account before they are actually paid to the plan is available only for plan years beginning before 2009. Furthermore, if the employer does not actually make the contribution and the difference between the incorrect certification and the corrected AFTAP constitutes a material change, the plan will have violated section 401(a)(29) or will not have been operated in accordance with its terms.

Example 3. (i) Plan R is a defined benefit plan with a plan year that is the calendar year and a valuation date of January 1. The first effective plan year for Plan R is 2008. The valuation interest rate for the 2007 plan year for Plan R is 7%. The fair market value of assets of Plan R as of January 1, 2007, is $1,000,000. The actuarial value of assets of Plan R as of January 1, 2007, is $1,200,000. The current liability of Plan R as of January 1, 2007, is $1,500,000. The funding standard account credit balance as of January 1, 2007, is $80,000. The funding standard carryover balance of Plan R is $50,000 as of the beginning of the 2008 plan year. The sponsor of Plan R, Sponsor T, elects in 2008 to reduce the funding standard carryover balance in accordance with §1.430(f)–1 by $45,000.

(ii) Pursuant to paragraph (j)(2)(iii)(B)(*1*) of this section, the asset value used to determine the funding target attainment percentage (FTAP) for the 2007 plan year is limited to 110% of the fair market value of assets on January 1, 2007, or $1,100,000 (110% of $1,000,000).

(iii) Pursuant to paragraph (j)(2)(iii)(B)(*2*) of this section, the funding standard account credit balance as of January 1, 2007, is subtracted from the asset value used to determine the FTAP for the 2007 plan year. However, pursuant to paragraph (j)(2)(iii)(B)(*3*) of this section, the present value of the amount by which Sponsor T elected to reduce the funding standard carryover balance in 2008 is not subtracted.

(iv) The present value, determined at an interest rate of 7%, of the $45,000 reduction in the funding standard account carryover balance elected by Sponsor T in 2008 is $42,056. Thus, $42,056 is not subtracted from the 2007 plan year asset value. Accordingly, the funding standard account credit balance that is subtracted from the 2007 plan year asset value is $37,944 (that is, $80,000 less $42,056).

(v) Thus, the asset value that is used to determine the FTAP for the 2007 plan year is $1,100,000 less $37,944, or $1,062,056. Accordingly, for purposes of this section, the FTAP for the 2007 plan year for Plan R is 70.8% (that is, $1,062,056 divided by $1,500,000).

(k) *Effective/applicability dates*—(1) *In general.* In general, this section applies to plan years beginning on or after January 1, 2008.

(2) *Plans with delayed effective/applicability date.* In the case of a plan for which the effective date of section 436 is delayed in accordance with sections 104 through 106 of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, this section applies to plan years beginning on or after the effective date of section 436 with respect to the plan.

(3) *Collective bargaining exception*—(i) *In general.* In the case of a collectively bargained plan that is maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before January 1, 2008, this section does not apply to plan years beginning before the earlier of—

(A) The date described in paragraph (k)(3)(ii) of this section; or

(B) January 1, 2010.

(ii) *Termination of collective bargaining agreement.* The date described in this paragraph (k)(3)(ii) is the later of—

(A) The date on which the last collective bargaining agreement relating to the plan terminates (determined in accordance with paragraph (k)(3)(iii) of this section and without regard to any extension thereof agreed to after August 17, 2006); or

(B) The first day of the first plan year to which this section would (but for this paragraph (k)(3)) apply.

(iii) *Treatment of certain plan amendments.* Any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by section 436 is not treated as a termination of the collective bargaining agreement.

(iv) *Treatment of plans with both collectively bargained and non-collectively bargained employees.* In the case of a plan with respect to which a collective bargaining agreement applies to some, but not all, of the plan participants, the plan is considered a collectively bargained plan for purposes of this paragraph (k)(3) if it is considered a collectively bargained plan under the rules of paragraph (a)(5)(ii)(B) of this section.

(4) *First effective plan year.* For purposes of this section, the first effective plan year for a plan is the first plan year to which this section applies under paragraph (k)(1), (k)(2), or (k)(3) of this section.

(5) *Pre-effective plan year.* For purposes of this section, the pre-effective plan year for a plan is the last plan year beginning before the effective date applicable under paragraph (k)(1), (k)(2), or (k)(3) of this section. Thus, except for plans with a delayed effective date under paragraph (k)(2) or (k)(3) of this section, the pre-effective plan year for a plan is the last plan year beginning before January 1, 2008.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 28, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 31, 2007, 72 F.R. 50543)

Temporary Closing of the Determination Letter Program for Adopters of Pre-Approved Defined Contribution Plans

Announcement 2007–90

On December 18, 2007, the Service will temporarily stop accepting applications for determination letters for defined contribution plans that are filed on Form 5307, *Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans.* The Service is taking this action because all pre-approved (*i.e.*, master and prototype and volume submitter) defined contribution plans are required to be restated to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16, ("EGTRRA") and to be submitted to the Service for a determination letter (if needed) using Form 5307 during the approximately two-year period which the Service expects to announce early in 2008. The temporary hiatus in accepting Form 5307 applications will allow the Service to prepare to receive the EGTRRA applications.

Rev. Proc. 2007–44, 2007–28 I.R.B. 54, and Rev. Proc. 2005–16, 2005–1 C.B. 674, describe a staggered remedial amendment system for plans that are qualified under § 401(a) of the Internal Revenue Code, with five-year amendment/approval cycles for individually designed plans and six-year cycles for pre-approved plans. The submission period for the initial six-year cycle for pre-approved defined contribution plans ran from February 17, 2005, to January 31, 2006. Sponsors and practitioners were required to restate their pre-approved defined contribution plans for EGTRRA and other changes in plan qualification requirements described in Notice 2004–84, 2004–2 C.B. 1030, the "2004 Cumulative List," and apply for new opinion or advisory letters during this submission period. As provided in Rev. Proc. 2007–44, when the review of the pre-approved defined contribution plans is near completion, the Service will publish an announcement providing the date by which adopting employers must adopt the newly approved plans. This date will also be the deadline for adopting employers to file Form 5307 determination letter applications for their EGTRRA-restated pre-approved defined contribution plans. The Service expects to publish this announcement early next year and anticipates that adopting employers will have approximately two years to adopt the restated plans and request determination letters.

In order to prepare to receive the Form 5307 applications for the EGTRRA-restated defined contribution plans that will be filed starting next year, the Service will temporarily stop accepting determination letter applications for defined contribution plans filed on Form 5307, beginning December 18, 2007. The Service will continue to process determination letter applications for defined contribution plans filed on Form 5307 before December 18, 2007, provided the plan has a favorable

GUST[1] opinion or advisory letter. Any determination letter application for a defined contribution plan filed on Form 5307 on or after December 18, 2007 and before the opening of the approximately two-year period for adopting EGTRRA-restated pre-approved defined contribution plans will be returned to the applicant.

This announcement does not affect the ability of adopting employers to apply for determination letters on Form 5307 for pre-approved defined benefit plans. The Service will continue to accept and process such applications until further notice. This announcement also does not affect the ability of adopting employers of pre-approved plans (whether defined contribution or defined benefit) to apply on Form 5307 for a determination letter for plan amendments related to a voluntary correction program (VCP) submission or as required under the correction on audit program (Audit CAP), under the procedures described in Rev. Proc. 2006–27, 2006–1 C.B. 945.

Employee Benefits—Cafeteria Plans; Hearing

Announcement 2007–91

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change of location for public hearing.

SUMMARY: This document provides a change of location for a public hearing on proposed regulations (REG–142695–05, 2007–39 I.R.B. 681) providing guidance on cafeteria plans.

DATES: The public hearing is being held on Thursday, November 15, 2007, at 10 a.m.

ADDRESSES: The public hearing was originally being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The hearing location has changed. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: LaNita Van Dyke, (202) 622–3215 or Oluwafunmilayo Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is a notice of proposed rulemaking (REG–142695–05) that was published in the **Federal Register** on Monday, August 6, 2007 (72 FR 43938).

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons, who submit outlines and written comments by October 25 and November 5, 2007 respectively, may present oral comments at the hearing.

A period of 10 minutes is allotted to each person for presenting oral comments. The IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on September 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 21, 2007, 72 F.R. 53977)

Section 67 Limitations on Estates or Trusts; Hearing

Announcement 2007–92

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change of location for public hearing.

SUMMARY: This document provides a change of location for a public hearing on proposed regulations (REG–128224–06, 2007–36 I.R.B. 551) providing guidance on which costs incurred by estates or non-grantor trusts are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

DATES: The public hearing is being held on Wednesday, November 14, 2007, at 10 a.m.

ADDRESSES: The public hearing was originally being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. The hearing location has changed. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: LaNita Van Dyke, (202) 622–3215 or Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is a notice of proposed rulemaking (REG–128224–06) that was published in the **Federal Register** on Friday, July 27, 2007 (72 FR 41243).

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons, who submit outlines and written comments by October 24 and 25, 2007 respectively, may present oral comments at the hearing.

A period of 10 minutes is allotted to each person for presenting oral comments. The IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on September 20, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 21, 2007, 72 F.R. 53977)

Change to Office to Which Notices of Nonjudicial Sale and Requests for Return of Wrongfully Levied Property Must Be Sent; Correction

Announcement 2007–93

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final and temporary regulations.

SUMMARY: This document contains corrections to final and temporary regulations (T.D. 9344, 2007–36 I.R.B. 535) that were published in the Federal Register on Friday, July 20, 2007 relating to the discharge of liens under section 7425 and return of wrongfully levied property under section 6343.

FOR FURTHER INFORMATION CONTACT: Robin M. Ferguson at (202) 622–3630.

SUPPLEMENTARY INFORMATION:

Background

The final and temporary regulations (T.D. 9344) that are the subject of these corrections are under sections 7425 and 6343 of the Internal Revenue Code.

Need for Correction

As published, the final and temporary regulations (T.D. 9344) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the final and temporary regulations (T.D. 9344) that were the subject of FR. Doc. E7–14053 are corrected as follows:

1. On page 39738, column 1, in the preamble, under the caption "FOR FURTHER INFORMATION CONTACT:", line 2, the language "Robin M. Ferguson, (202) 622–3610 (not" is corrected to read "Robin M. Ferguson, (202) 622–3630 (not".

2. On page 39739, column 1, in the preamble, under paragraph heading "Drafting Information", lines 4 and 5, the language "and Administration (Collection, Bankruptcy and Summonses Division)" should be corrected to read "and Administration."

LaNita Van Dyke,
Branch Chief,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 23, 2007, 72 F.R. 48236)

Change to Office to Which Notices of Nonjudicial Sale and Requests for Return of Wrongfully Levied Property Must Be Sent; Correction

Announcement 2007–94

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–148951–05, 2007–36 I.R.B. 550) by cross-reference to temporary regulations that was published in the Federal Register on Friday, July 20, 2007 relating to the discharge of liens under section 7425 and return of wrongfully levied property under section 6343.

FOR FURTHER INFORMATION CONTACT: Robin M. Ferguson at (202) 622–3630.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking by cross-reference to temporary regulations (REG–148951–05) that is the subject of these corrections is under sections 7425 and 6343 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking by cross-reference to temporary regulations (REG–148951–05) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking by cross-reference to temporary regulations (REG–148951–05) that was the subject of FR. Doc. E7–14051 is corrected as follows:

1. On page 39771, column 3, in the preamble, under the caption "FOR FURTHER INFORMATION CONTACT:", line 1, the language "Robin M. Ferguson, (202) 622–3610; is corrected to read "Robin M. Ferguson, (202) 622–3630;".

2. On page 39772, column 1, in the preamble, under paragraph heading "Drafting Information", lines 4 and 5, the language "and Administration (Collection, Bankruptcy and Summonses Division)" should be corrected to read "and Administration."

LaNita Van Dyke,
Branch Chief,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 23, 2007, 72 F.R. 48249)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–96

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 15, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

The Georgetown Foundation
Sandy, UT

Lumberton Family Life Center, Inc.
Lumberton, MS

Truth in Youth & Family Services, Inc.
Leland, NC

Cunningham Charitable Group
Los Angeles, CA

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1291.—Interest on Tax Deferral

26 CFR 1.1291–9: Deemed dividend election.

T.D. 9360

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Guidance on Passive Foreign Investment Company (PFIC) Purging Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of the temporary regulations.

SUMMARY: This document contains final regulations that provide certain elections for taxpayers that continue to be subject to the PFIC excess distribution regime of section 1291 of the Internal Revenue Code even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(a) or (e) of the Code. The regulations are necessary to provide guidance about purging the PFIC taint for such foreign corporations. The regulations will affect U.S. persons that hold stock in a PFIC.

DATES: *Effective Date:* These regulations are effective on September 27, 2007.

Applicability Date: For dates of applicability, see §§1.1291–9(k), 1.1297–3(f), 1.1298–3(f).

FOR FURTHER INFORMATION CONTACT: Paul J. Carlino at (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1965.

The collection of information in these final regulations is in §1.1297–3(c)(5)(ii). This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or is claiming the correct amount of losses, deductions or credits from that taxpayer's interest in the foreign corporation.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On December 8, 2005, the IRS and the Treasury Department published final regulations under section 1298(b)(1) and removal of temporary regulations (T.D. 9231, 2006–1 C.B. 272) in the **Federal Register** (70 FR 72914). The final regulations provided rules for a shareholder of a former PFIC (as defined in §1.1291–9(j)(2)(iv)) to make a deemed dividend or deemed sale election to purge the PFIC taint of the stock of the foreign corporation (that is, to end treatment of the stock of the foreign corporation as PFIC stock with respect to the shareholder). On December 8, 2005, the Internal Revenue Service and the Treasury Department also published temporary regulations (T.D. 9232, 2006–1 C.B. 266) under sections 1291(d)(2), 1297(e) and 1298(b)(1) in the **Federal Register** (70 FR 72908). A notice of proposed rulemaking (REG–133446–03, 2006–1 C.B. 299) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (70 FR 72952). The temporary and proposed regulations provided guidance to shareholders of section 1297(e) PFICs (as defined in §1.1291–9(j)(2)(v)) on making a deemed sale or deemed dividend election to purge the PFIC taint of the stock of the foreign corporation. The temporary and proposed regulations also provided guidance to shareholders of section 1297(e) PFICs and shareholders of former PFICs on making late purging elections (provided certain requirements are met).

No public hearing was requested or held. A comment responding to the notice of proposed rulemaking was received. After consideration of the comment, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The comment and revision is discussed in this preamble.

Summary of Comments and Explanation of Revisions

1. *Multiple Purging Elections*

Sections 1.1297–3 and 1.1298–3 provide guidance for a shareholder of a section 1297(e) PFIC and a shareholder of a former PFIC, respectively, to make a deemed sale or a deemed dividend election to purge the PFIC taint of the stock of the foreign corporation. A *section 1297(e) PFIC* is a foreign corporation that qualifies as a PFIC under section 1297(a) on the first day of the qualified portion of the shareholder's holding period under section 1297(e), and is treated as a PFIC with respect to the shareholder under section 1298(b)(1) because at any time during the shareholder's holding period of the stock, other than the qualified portion, the foreign corporation was a PFIC that was not a qualified electing fund (QEF) under section 1295. (The "qualified portion" is the portion of the shareholder's holding period which is after December 31, 1997, and during which the shareholder is a U.S. shareholder (as defined in section 951(b)) and the foreign corporation is a controlled foreign corporation.) A *former PFIC* is a foreign corporation that satisfies neither the income nor the asset test of section 1297(a), but whose stock held by a shareholder is treated as stock of a PFIC, pursuant to section 1298(b)(1), because the corporation was a PFIC that was not a

QEF at some time during the shareholder's holding period of the stock.

Sections 1.1297–3(e) and 1.1298–3(e) provide rules for making late purging elections when the time prescribed for making timely purging elections under §§1.1297–3(b)(3) or (c)(4) and 1.1298–3(b)(3) or (c)(4) has elapsed.

One commentator requested that the final regulations clarify whether multiple late purging elections can be made under §§1.1297–3(e) and 1.1298–3(e). The IRS and the Treasury Department believe that multiple late purging elections should be allowed to the same extent such multiple purging elections could have been made if filed timely. The final regulations are amended to clarify this rule.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations affect only U.S. persons with stock ownership in a PFIC. There are not a substantial number of U.S. persons that are small entities that own stock in a PFIC. Further, the economic costs necessary to comply with the rule for the small entities that may be impacted are not significant. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this final regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Paul J. Carlino of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1291–9 is amended by revising paragraphs (i), (j)(2)(v) and (k) to read as follows:

§1.1291–9 Deemed dividend election.

* * * * *

(i) *Election inapplicable to shareholder of a former PFIC or of a section 1297(e) PFIC.* A shareholder may not make the section 1295 and deemed dividend elections if the foreign corporation is a former PFIC (as defined in paragraph (j)(2)(iv) of this section) or a section 1297(e) PFIC (as defined in paragraph (j)(2)(v) of this section) with respect to the shareholder. For the rules regarding the election by a shareholder of a former PFIC, see §1.1298–3. For the rules regarding the election by a shareholder of a section 1297(e) PFIC, see §1.1297–3.

(j) * * *

(2) * * *

(v) *Section 1297(e) PFIC.* A foreign corporation is a section 1297(e) PFIC with respect to a shareholder (as defined in paragraph (j)(3) of this section) if—

(A) The foreign corporation qualifies as a PFIC under section 1297(a) on the first day on which the qualified portion of the shareholder's holding period in the foreign corporation begins, as determined under section 1297(e)(2); and

(B) The stock of the foreign corporation held by the shareholder is treated as stock of a PFIC, pursuant to section 1298(b)(1), because, at any time during the shareholder's holding period of the stock, other than the qualified portion, the corporation was a PFIC that was not a QEF.

(k) *Effective/applicability date.* (1) The rules of this section, except for paragraph (j)(2)(v) of this section, are applicable as of April 1, 1995.

(2) The rules of paragraph (j)(2)(v) of this section are applicable as of December 8, 2005.

§1.1291–9T [Removed]

Par. 3. Section 1.1291–9T is removed.

Par. 4. Section 1.1297–0 is revised to read as follows:

§1.1297–0 Table of contents.

This section contains a listing of the headings for §1.1297–3.

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of the deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post-1986 earnings and profits defined.

(4) Time for making the deemed dividend election.

(5) Manner of making the deemed dividend election.

(6) Adjustments to basis.

(7) Treatment of holding period.

(8) Coordination with section 959(e).

(d) CFC qualification date.

(e) Late purging elections requiring special consent.

(1) In general.

(2) Prejudice to the interests of the U.S. government.

(3) Procedural requirements.

(4) Time and manner of making late election.

(5) Multiple late elections.

(f) Effective/applicability date.

§1.1297–0T [Removed]

Par. 5. Section 1.1297–0T is removed.

Par. 6. Section 1.1297–3 is added to read as follows:

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

(a) *In general.* A shareholder (as defined in §1.1291–9(j)(3)) of a foreign corporation that is a section 1297(e) passive foreign investment company (PFIC) (as defined in §1.1291–9(j)(2)(v)) with respect to such shareholder, shall be treated for tax purposes as holding stock in a PFIC and therefore continues to be subject to taxation under section 1291 unless the shareholder makes a purging election under section 1298(b)(1). A purging election under section 1298(b)(1) is made under rules similar to the rules of section 1291(d)(2). Section 1291(d)(2) allows a shareholder to purge the continuing PFIC taint by either making a deemed sale election or a deemed dividend election.

(b) *Application of deemed sale election rules*—(1) *Eligibility to make the deemed sale election.* A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make a deemed sale election under section 1298(b)(1) by applying the rules of this paragraph (b).

(2) *Effect of the deemed sale election.* A shareholder making the deemed sale election with respect to a section 1297(e) PFIC shall be treated as having sold all of its stock in the section 1297(e) PFIC for its fair market value on the controlled foreign corporation (CFC) qualification date, as defined in paragraph (d) of this section. A deemed sale under this section is treated as a disposition subject to taxation under section 1291. Thus, the gain from the deemed sale is taxed as an excess distribution received on the CFC qualification date. In the case of an election made by an indirect shareholder, the amount of gain to be recognized and taxed as an excess distribution is the amount of gain that the direct owner of the stock of the PFIC would have realized on an actual sale or disposition of the stock of the PFIC indirectly owned by the shareholder. Any loss realized on the deemed sale is not recognized. After the deemed sale election, the shareholder's stock with respect to which the election was made under this paragraph (b) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of the shareholder's holding period ends, as determined under section 1297(e)(2), and the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Time for making the deemed sale election.* Except as provided in paragraph (e) of this section, a shareholder shall make the deemed sale election under this paragraph (b) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed sale election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(4) *Manner of making the deemed sale election.* A shareholder makes the deemed sale election under this paragraph (b) by filing Form 8621, *"Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund"*, with the return of the shareholder for the election year, reporting the gain as an excess distribution pursuant to section 1291(a) as if such sale occurred under section 1291(d)(2), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed sale election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year. An electing shareholder that realizes a loss shall report the loss on Form 8621, but shall not recognize the loss.

(5) *Adjustments to basis.* A shareholder that makes the deemed sale election increases its adjusted basis of the PFIC stock owned directly by the amount of gain recognized on the deemed sale. If the shareholder makes the deemed sale election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of gain recognized by the shareholder. In addition, solely for purposes of determining the subsequent treatment under the Internal Revenue Code (Code) and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of gain recognized on the deemed sale. A shareholder shall not adjust the basis of any stock with respect to which the shareholder realized a loss on the deemed sale, which loss is not recognized under paragraph (b)(2) of this section.

(6) *Treatment of holding period.* If a shareholder of a foreign corporation has made a deemed sale election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed sale, the shareholder's holding period in the stock of the foreign corporation begins on the CFC qualification date, without regard to whether the shareholder recognized gain on the deemed sale. For other purposes of the Code and regulations, this holding period rule does not apply.

(c) *Application of deemed dividend election rules*—(1) *Eligibility to make the deemed dividend election.* A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make the deemed dividend election under the rules of this paragraph (c). A deemed dividend election may be made by a shareholder whose *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the PFIC stock held on the CFC qualification date is zero.

(2) *Effect of the deemed dividend election.* A shareholder making the deemed dividend election with respect to a section 1297(e) PFIC shall include in income as a dividend its *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to all of the stock it held, directly or indirectly on the CFC qualification date, as defined in paragraph (d) of this section. The deemed dividend is taxed under section 1291 as an excess distribution received on the CFC qualification date. The excess distribution determined under this paragraph (c) is allocated under section 1291(a)(1)(A) only to each day of the shareholder's holding period of the stock during which the foreign corporation qualified as a PFIC. For purposes of the preceding sentence, the shareholder's holding period of the PFIC stock ends on the day before the CFC qualification date. After the deemed dividend election, the shareholder's stock with respect to which the election was made under this paragraph (c) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of

the shareholder's holding period ends, as determined under section 1297(e)(2), and the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Post-1986 earnings and profits defined*—(i) *In general*—(A) *General rule.* For purposes of this section, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the day before the CFC qualification date, that were accumulated and not distributed in taxable years of the PFIC beginning after 1986 and during which it was a PFIC, without regard to whether the earnings related to a period during which the PFIC was a CFC.

(B) *Special rule.* If the CFC qualification date is a day that is after the first day of the taxable year, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the close of the taxable year that includes the CFC qualification date. For purposes of this computation, only earnings and profits accumulated in taxable years during which the foreign corporation was a PFIC shall be taken into account, but without regard to whether the earnings related to a period during which the PFIC was a CFC.

(ii) *Pro rata share of post-1986 earnings and profits attributable to shareholder's stock*—(A) *In general.* A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the stock held by the shareholder on the CFC qualification date is the amount of post-1986 earnings and profits of the PFIC accumulated during any portion of the shareholder's holding period ending at the close of the day before the CFC qualification date and attributable, under the principles of section 1248 and the regulations under that section, to the PFIC stock held on the CFC qualification date.

(B) *Reduction for previously taxed amounts.* A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC does not include any amount that the shareholder demonstrates to the satisfaction of the Commissioner (in the manner provided in paragraph (c)(5)(ii) of this section) was, pursuant to another provision of the law, previously included in the income of the shareholder, or of another U.S. person if the shareholder's holding period of the PFIC stock includes the period during which the stock was held by that other U.S. person.

(4) *Time for making the deemed dividend election.* Except as provided in paragraph (e) of this section, the shareholder shall make the deemed dividend election under this paragraph (c) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed dividend election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(5) *Manner of making the deemed dividend election*—(i) *In general.* A shareholder makes the deemed dividend election by filing Form 8621 and the attachment to Form 8621 described in paragraph (c)(5)(ii) of this section with the return of the shareholder for the election year, reporting the deemed dividend as an excess distribution pursuant to section 1291(a)(1), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed dividend election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year.

(ii) *Attachment to Form 8621.* The shareholder must attach a schedule to Form 8621 that demonstrates the calculation of the shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC that is treated as distributed to the shareholder on the CFC qualification date, pursuant to this paragraph (c). If the shareholder is claiming an exclusion from its *pro rata* share of the post-1986 earnings and profits for an amount previously included in its income or the income of another U.S. person, the shareholder must include the following information:

(A) The name, address and taxpayer identification number of each U.S. person that previously included an amount in income, the amount previously included in income by each such U.S. person, the provision of law, pursuant to which the amount was previously included in income, and the taxable year or years of inclusion of each amount.

(B) A description of the transaction pursuant to which the shareholder acquired, directly or indirectly, the stock of the PFIC from another U.S. person, and the provision of law pursuant to which the shareholder's holding period includes the period the other U.S. person held the CFC stock.

(6) *Adjustments to basis.* A shareholder that makes the deemed dividend election increases its adjusted basis of the stock of the PFIC owned directly by the shareholder by the amount of the deemed dividend. If the shareholder makes the deemed dividend election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of the deemed dividend. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of the deemed dividend.

(7) *Treatment of holding period.* If the shareholder of a foreign corporation has made a deemed dividend election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed dividend, the shareholder's holding period of the stock of the foreign corporation begins on the CFC qualification date. For other purposes of the Code and regulations, this holding period rule does not apply.

(8) *Coordination with section 959(e).* For purposes of section 959(e), the entire deemed dividend is treated as having been included in gross income under section 1248(a).

(d) *CFC qualification date.* For purposes of this section, the CFC qualification date is the first day on which the qualified portion of the shareholder's holding period in the section 1297(e) PFIC begins, as determined under section 1297(e).

(e) *Late purging elections requiring special consent*—(1) *In general.* This section prescribes the exclusive rules under which a shareholder of a section 1297(e) PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(3) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election).

Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late deemed sale or deemed dividend election for the taxable year of the shareholder that includes the CFC qualification date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after December 31, 2005, the shareholder requests such consent before a representative of the Internal Revenue Service (IRS) raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the CFC qualification date falls or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government.* The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the CFC qualification date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirements*—(i) *In general.* The amount due with respect to a late purging election is determined in the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, pursuant to section 6601, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the CFC qualification date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions.* A late purging election is made by filing a completed Form 8621–A, *"Return by a Shareholder Making Certain Late Elections To End Treatment as a Passive Foreign Investment Company."*

(4) *Time and manner of making late election*—(i) *Time for making a late purging election.* A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election.* A shareholder makes a late purging election by completing Form 8621–A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621–A, Ogden, UT 84201.

(5) *Multiple late elections*—(i) *General rule.* A shareholder of a foreign corporation may make multiple late purging elections under the rules of this paragraph (e) or §1.1298–3(e) to the same extent such multiple purging elections could have been made if those purging elections had been filed within the time prescribed under paragraph (b)(3) or (c)(4) of this section or §1.1298–3(b)(3) or (c)(4).

(ii) *Example.* The rule of this paragraph (e)(5) is illustrated by the following example:

Example. (i) In 1991, X, a U.S person, acquired a five percent interest in the stock of FC, a controlled foreign corporation, as defined in section 957(a). In years 1991, 1992, 1995, 1996 and 1997, FC satisfied either the income test or the asset test of section 1297(a). X did not make a QEF election with regard to FC. In years 1993 and 1994, FC did not satisfy either the income or the asset test of section 1297(a). In 1998, X acquired additional stock in FC such that X was a U.S. shareholder (as defined in section 951(b)) of FC.

(ii) Because FC qualified as a PFIC in 1991, FC will be treated as a PFIC with respect to all of the stock held by X, under the "once a PFIC always a PFIC" rule of section 1298(b)(1), unless X makes an election to purge the PFIC taint. Because X ceased to satisfy either the income or asset test in 1993, X could have made an election under §1.1298–3 to purge the PFIC taint of FC for that year if X had filed such an election within the time prescribed under §1.1298–3(b)(3) or (c)(4). If X had done so, the stock X held in FC would not be treated as stock in a PFIC for the years 1993 and 1994. Because X became a U.S. shareholder of FC in 1998, X then could have made a deemed sale or deemed dividend election under this section to purge the PFIC taint of FC for the years 1995 through 1997 if X had filed within the time prescribed under paragraph (b)(3) or (c)(4) of this section. Accordingly, X may make a late purging election to purge the PFIC taint of FC for the years 1991 and 1992 under the rules of §1.1298–3(e) and may also make a late purging election to purge the PFIC taint of FC for the years 1995 through 1997 under the rules of this paragraph (e).

(f) *Effective/applicability date.* The rules of this section are applicable as of December 8, 2005.

§1.1297–3T [Removed]

Par. 7. Section 1.1297–3T is removed.

Par. 8. Section 1.1298–0 is revised to read as follows:

§1.1298–0 Table of contents.

This section contains a listing of the paragraph headings for §1.1298–3.

§1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of the deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post-1986 earnings and profits defined.

(4) Time for making the deemed dividend election.
(5) Manner of making the deemed dividend election.
(6) Adjustments to basis.
(7) Treatment of holding period.
(8) Coordination with section 959(e).
(d) Termination date.
(e) Late purging elections requiring special consent.
(1) In general.
(2) Prejudice to the interests of the U.S. government.
(3) Procedural requirements.
(4) Time and manner of making late election.
(5) Multiple late elections.
(f) Effective/applicability date.

§1.1298–0T [Removed]

Par. 9. Section 1.1298–0T is removed.

Par. 10. Section 1.1298–3 is amended by revising paragraphs (e) and (f) to read as follows:

§1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

* * * * *

(e) *Late purging elections requiring special consent*—(1) *In general.* This section prescribes the exclusive rules under which a shareholder of a former PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(3) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election). Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late purging election for the taxable year of the shareholder that includes the termination date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after December 31, 2005, the shareholder requests such consent before a representative of the Internal Revenue Service raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the termination date falls or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government.* The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the termination date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirements*—(i) *In general.* The amount due with respect to a late purging election is determined in the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, pursuant to section 6601, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the termination date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions.* A late purging election is made by filing a completed Form 8621–A, *"Return by a Shareholder Making Certain Late Elections To End Treatment as a Passive Foreign Investment Company."*

(4) *Time and manner of making late election*—(i) *Time for making a late purging election.* A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election.* A shareholder makes a late purging election by completing Form 8621–A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621–A, Ogden, UT 84201.

(5) *Multiple late elections.* For rules regarding the circumstances under which a shareholder of a foreign corporation may make multiple late purging elections under this paragraph (e) or §1.1297–3(e), see §1.1297–3(e)(5).

(f) *Effective/applicability date.* The rules of this section are applicable as of December 8, 2005.

§1.1298–3T [Removed]

Par. 11. Section 1.1298–3T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation of part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In §602.101, paragraph (b) is amended by removing the entry for "1.1297–3T" from the table.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved September 17, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 26, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 27, 2007, 72 F.R. 54820)

Section 1297.—Passive Foreign Investment Company

A final regulation provides guidance regarding a deemed sale or deemed dividend election for certain U.S. shareholders of a former passive foreign investment company (PFIC) or a section 1297(e) PFIC. See T.D. 9360, page 860.

Section 1298.—Special Rules

A final regulation provides guidance regarding a deemed sale or deemed dividend election for certain U.S. shareholders of a former passive foreign investment company (PFIC) or a section 1297(e) PFIC. See T.D. 9360, page 860.

Section 1361.—S Corporation Defined

Proposed regulations provide rules relating to inadvertent terminations of S corporation and qualified subchapter S subsidiary elections and inadvertently ineffective elections. See REG-143326-05, page 873.

Section 1362.—Election; Revocation; Termination

Proposed regulations provide rules relating to inadvertent terminations of S corporation and qualified subchapter S subsidiary elections and inadvertently ineffective elections. See REG-143326-05, page 873.

Section 1366.—Pass-Thru of Items to Shareholders

Proposed regulations provide rules on the transfer of suspended losses associated with S corporation stock to spouses and former spouses of S corporation shareholders. See REG-143326-05, page 873.

Part III. Administrative, Procedural, and Miscellaneous

Extension of Replacement Period for Livestock Sold on Account of Drought in Specified Counties

Notice 2007–80

SECTION 1. PURPOSE

This notice provides guidance regarding an extension of the replacement period under § 1033(e) of the Internal Revenue Code for livestock sold on account of drought in specified counties.

SECTION 2. BACKGROUND

.01 *Nonrecognition of Gain on Involuntary Conversion of Livestock.* Section 1033(a) generally provides for nonrecognition of gain when property is involuntarily converted and replaced with property that is similar or related in service or use. Section 1033(e)(1) provides that a sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number that would be sold following the taxpayer's usual business practices is treated as an involuntary conversion if the livestock is sold or exchanged solely on account of drought, flood, or other weather-related conditions.

.02 *Replacement Period.* Section 1033(a)(2)(A) generally provides that gain from an involuntary conversion is recognized only to the extent the amount realized on the conversion exceeds the cost of replacement property purchased during the replacement period. If a sale or exchange of livestock is treated as an involuntary conversion under § 1033(e)(1) and is solely on account of drought, flood, or other weather-related conditions that result in the area being designated as eligible for assistance by the federal government, § 1033(e)(2)(A) provides that the replacement period ends four years after the close of the first taxable year in which any part of the gain from the conversion is realized. Section 1033(e)(2)(B) provides that the Secretary may extend this replacement period on a regional basis for such additional time as the Secretary determines appropriate if the weather-related conditions that resulted in the area being designated as eligible for assistance by the federal government continue for more than three years. Section 1033(e)(2) is effective for any taxable year with respect to which the due date (without regard to extensions) for a taxpayer's return is after December 31, 2002.

SECTION 3. EXTENSION OF REPLACEMENT PERIOD UNDER SECTION 1033(e)(2)(B)

Notice 2006–82, 2006–39 I.R.B. 529, provides for extensions of the replacement period under § 1033(e)(2)(B). If a sale or exchange of livestock is treated as an involuntary conversion on account of drought and the taxpayer's replacement period is determined under § 1033(e)(2)(A), the replacement period will be extended under § 1033(e)(2)(B) and Notice 2006–82 until the end of the taxpayer's first taxable year ending after the first drought-free year for the applicable region. For this purpose, the first drought-free year for the applicable region is the first 12-month period that (1) ends August 31; (2) ends in or after the last year of the taxpayer's 4-year replacement period determined under § 1033(e)(2)(A); and (3) does not include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the applicable region. The applicable region is the county that experienced the drought conditions on account of which the livestock was sold or exchanged and all counties that are contiguous to that county.

A taxpayer may determine whether exceptional, extreme, or severe drought is reported for any location in the applicable region by reference to U.S. Drought Monitor maps that are produced on a weekly basis by the National Drought Mitigation Center. U.S. Drought Monitor maps are archived at *www.drought.unl.edu/dm/archive.html.*

In addition, Notice 2006–82 provides that the Internal Revenue Service will publish in September of each year a list of counties, districts, cities, or parishes (hereinafter "counties") for which exceptional, extreme, or severe drought was reported during the preceding 12 months. Taxpayers may use this list instead of U.S. Drought Monitor maps to determine whether exceptional, extreme, or severe drought has been reported for any location in the applicable region.

The Appendix to this notice contains the list of counties for which exceptional, extreme, or severe drought was reported during the 12-month period ending August 31, 2007. Under Notice 2006–82, the 12-month period ending on August 31, 2007, is not a drought-free year for an applicable region that includes any county on this list. Accordingly, for a taxpayer who qualified for a four-year replacement period for livestock sold or exchanged on account of drought and whose replacement period is scheduled to expire at the end of 2007 (or, in the case of a fiscal year taxpayer, at the end of the taxable year that includes August 31, 2007), the replacement period will be extended under § 1033(e)(2) and Notice 2006–82 if the applicable region includes any county on this list. This extension will continue until the end of the taxpayer's first taxable year ending after a drought-free year for the applicable region.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Jeffrey Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Marshall at (202) 622–7287 (not a toll-free call).

Alabama

Counties of Autauga, Baldwin, Barbour, Bibb, Blount, Bullock, Butler, Calhoun, Chambers, Cherokee, Chilton, Choctaw, Clarke, Clay, Cleburne, Coffee, Colbert, Conecuh, Coosa, Covington, Crenshaw, Cullman, Dale, Dallas, DeKalb, Elmore, Escambia, Etowah, Fayette, Franklin, Geneva, Greene, Hale, Henry, Houston, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Lee, Limestone, Lowndes, Macon, Madison, Marengo, Marion, Marshall, Mobile, Monroe, Montgomery, Morgan, Perry, Pickens, Pike, Randolph, Russell, St. Clair, Shelby, Sumter, Talladega, Tallapoosa, Tuscaloosa, Walker, Washington, Wilcox, Winston.

Arizona

Counties of Apache, Cochise, Coconino, Gila, La Paz, Maricopa, Mohave, Navajo, Pima, Pinal, Santa Cruz, Yavapai, Yuma.

Arkansas

Counties of Arkansas, Ashley, Bradley, Calhoun, Chicot, Clark, Clay, Cleburne, Cleveland, Columbia, Conway, Craighead, Crittenden, Cross, Dallas, Desha, Drew, Faulkner, Grant, Greene, Hempstead, Howard, Independence, Jackson, Jefferson, Lafayette, Lawrence, Lee, Lincoln, Little River, Lonoke, Miller, Mississippi, Monroe, Nevada, Ouachita, Perry, Phillips, Pike, Poinsett, Polk, Prairie, Pulaski, Randolph, St. Francis, Saline, Scott, Sevier, Sharp, Stone, Union, Van Buren, White, Woodruff.

California

Counties of Alameda, Alpine, Amador, Calaveras, El Dorado, Fresno, Imperial, Inyo, Kern, Kings, Lassen, Los Angeles, Madera, Mariposa, Merced, Modoc, Mono, Monterey, Nevada, Orange, Placer, Plumas, Riverside, San Benito, San Bernardino, San Diego, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Sierra, Stanislaus, Tulare, Tuolumne, Ventura.

Colorado

Counties of Adams, Arapahoe, Bent, Boulder, Broomfield, Cheyenne, Crowley, Denver, Dolores, Douglas, El Paso, Elbert, Jefferson, Kiowa, Kit Carson, La Plata, Larimer, Lincoln, Logan, Moffat, Montezuma, Morgan, Otero, Phillips, Prowers, Pueblo, San Miguel, Sedgwick, Washington, Weld, Yuma.

Delaware

Counties of Kent, Sussex.

The District of Columbia

Florida

Counties of Alachua, Baker, Bay, Bradford, Brevard, Broward, Calhoun, Charlotte, Citrus, Clay, Collier, Columbia, DeSoto, Dixie, Duval, Escambia, Flagler, Franklin, Gadsden, Gilchrist, Glades, Gulf, Hamilton, Hardee, Hendry, Highlands, Holmes, Indian River, Jackson, Jefferson, Lafayette, Lake, Lee, Leon, Levy, Liberty, Madison, Marion, Martin, Miami-Dade, Monroe, Nassau, Okaloosa, Okeechobee, Orange, Osceola, Palm Beach, Polk, Putnam, St. Johns, St. Lucie, Santa Rosa, Sumter, Suwannee, Taylor, Union, Volusia, Wakulla, Walton, Washington.

Georgia

Counties of Appling, Atkinson, Bacon, Baker, Baldwin, Banks, Barrow, Bartow, Ben Hill, Berrien, Bibb, Bleckley, Brantley, Brooks, Bryan, Bulloch, Burke, Butts, Calhoun, Camden, Candler, Carroll, Catoosa, Charlton, Chatham, Chattahoochee, Chattooga, Cherokee, Clarke, Clay, Clayton, Clinch, Cobb, Coffee, Colquitt, Columbia, Cook, Coweta, Crawford, Crisp, Dade, Dawson, Decatur, DeKalb, Dodge, Dooly, Dougherty, Douglas, Early, Echols, Effingham, Elbert, Emanuel, Evans, Fannin, Fayette, Floyd, Forsyth, Franklin, Fulton, Gilmer, Glascock, Glynn, Gordon, Grady, Greene, Gwinnett, Habersham, Hall, Hancock, Haralson, Harris, Hart, Heard, Henry, Houston, Irwin, Jackson, Jasper, Jeff Davis, Jefferson, Jenkins, Johnson, Jones, Lamar, Lanier, Laurens, Lee, Liberty, Lincoln, Long, Lowndes, Lumpkin, Macon, Madison, Marion, McDuffie, McIntosh, Meriwether, Miller, Mitchell, Monroe, Montgomery, Morgan, Murray, Muscogee, Newton, Oconee, Oglethorpe, Paulding, Peach, Pickens, Pierce, Pike, Polk, Pulaski, Putnam, Quitman, Rabun, Randolph, Richmond, Rockdale, Schley, Screven, Seminole, Spalding, Stephens, Stewart, Sumter, Talbot, Taliaferro, Tattnall, Taylor, Telfair, Terrell, Thomas, Tift, Toombs, Towns, Treutlen, Troup, Turner, Twiggs, Union, Upson, Walker, Walton, Ware, Warren, Washington, Wayne, Webster, Wheeler, White, Whitfield, Wilcox, Wilkes, Wilkinson, Worth.

Hawaii

Counties of Hawaii, Maui.

Idaho

Counties of Ada, Adams, Bannock, Bear Lake, Benewah, Bingham, Blaine, Boise, Bonner, Bonneville, Boundary, Butte, Camas, Canyon, Caribou, Cassia, Clark, Clearwater, Custer, Elmore, Franklin, Fremont, Gem, Gooding, Idaho, Jefferson, Jerome, Kootenai, Latah, Lemhi, Lewis, Lincoln, Madison, Minidoka, Nez Perce, Oneida, Owyhee, Payette, Power, Shoshone, Teton, Twin Falls, Valley, Washington.

Illinois

Counties of Alexander, Crawford, Edwards, Franklin, Gallatin, Hamilton, Hardin, Jackson, Jefferson, Johnson, Lawrence, Massac, Monroe, Perry, Pope, Pulaski, Randolph, Richland, Saline, Union, Wabash, Wayne, White, Williamson.

Indiana

Counties of Adams, Allen, Bartholomew, Blackford, Brown, Clark, Clay, Crawford, Daviess, Dearborn, Decatur, DeKalb, Delaware, Dubois, Elkhart, Fayette, Floyd, Franklin, Gibson, Grant, Greene, Hamilton, Hancock, Harrison, Hendricks, Henry, Howard, Huntington, Jackson, Jay, Jefferson, Jennings, Johnson, Knox, LaGrange, Lawrence, Madison, Marion, Martin, Monroe, Morgan, Noble, Ohio, Orange, Owen, Perry, Pike, Posey, Randolph, Ripley, Rush, Scott, Shelby, Spencer, Steuben, Sullivan, Switzerland, Tipton, Union, Vanderburgh, Wabash, Warrick, Washington, Wayne, Wells, Whitley.

Iowa

Counties of Clay, Dickinson, Emmet, Kossuth, Lyon, O'Brien, Osceola, Palo Alto, Plymouth, Sioux.

Kansas

Counties of Allen, Anderson, Barber, Bourbon, Butler, Chautauqua, Cherokee, Cheyenne, Clark, Comanche, Cowley, Crawford, Decatur, Elk, Greeley, Greenwood, Hamilton, Harper, Kingman, Kiowa, Labette, Linn, Logan, Miami, Montgomery, Neosho, Rawlins, Sedgwick, Sherman, Sumner, Thomas, Wallace, Wichita, Wilson, Woodson.

Kentucky

Counties of Adair, Allen, Anderson, Ballard, Barren, Bath, Bell, Boone, Bourbon, Boyd, Boyle, Bracken, Breathitt, Breckinridge, Bullitt, Butler, Caldwell, Calloway, Campbell, Carlisle, Carroll, Carter, Casey, Christian, Clark, Clay, Clinton, Crittenden, Cumberland, Daviess, Edmonson, Elliott, Estill, Fayette, Fleming, Floyd, Franklin, Fulton, Gallatin, Garrard, Grant, Graves, Grayson, Green, Greenup, Hancock, Hardin, Harlan, Harrison, Hart, Henderson, Henry, Hickman, Hopkins, Jackson, Jefferson, Jessamine, Johnson, Kenton, Knott, Knox, Larue, Laurel, Lawrence, Lee, Leslie, Letcher, Lewis, Lincoln, Livingston, Logan, Lyon, Madison, Magoffin, Marion, Marshall, Martin, Mason, McCracken, McCreary, McLean, Meade, Menifee, Mercer, Metcalfe, Monroe, Montgomery, Morgan, Muhlenberg, Nelson, Nicholas, Ohio, Oldham, Owen, Owsley, Pendleton, Perry, Pike, Powell, Pulaski, Robertson, Rockcastle, Rowan, Russell, Scott, Shelby, Simpson, Spencer, Taylor, Todd, Trigg, Trimble, Union, Warren, Washington, Wayne, Webster, Whitley, Wolfe, Woodford.

Louisiana

Parishes of Bossier, Caddo, De Soto, East Carroll, Madison, Morehouse, Sabine, Tensas, Webster, West Carroll.

Maryland

Counties of Anne Arundel, Baltimore, Calvert, Caroline, Carroll, Charles, Dorchester, Frederick, Howard, Kent, Montgomery, Prince George's, Queen Anne's, St. Mary's, Somerset, Talbot, Washington, Wicomico, Worcester.

Michigan

Counties of Alger, Allegan, Antrim, Baraga, Barry, Berrien, Branch, Cass, Charlevoix, Cheboygan, Chippewa, Delta, Dickinson, Emmet, Gogebic, Houghton, Iron, Kalamazoo, Keweenaw, Leelanau, Luce, Mackinac, Marquette, Menominee, Ontonagon, Ottawa, Presque Isle, St. Joseph, Schoolcraft, Van Buren.

Minnesota

Counties of Aitkin, Anoka, Becker, Beltrami, Benton, Big Stone, Blue Earth, Brown, Carlton, Carver, Cass, Chippewa, Chisago, Clearwater, Cook, Cottonwood, Crow Wing, Dakota, Dodge, Douglas, Faribault, Fillmore, Goodhue, Grant, Hennepin, Hubbard, Isanti, Itasca, Jackson, Kanabec, Kandiyohi, Kittson, Koochiching, Lac qui Parle, Lake, Lake of the Woods, Le Sueur, Lincoln, Lyon, Mahnomen, Marshall, Martin, McLeod, Meeker, Mille Lacs, Morrison, Murray, Nicollet, Nobles, Norman, Olmsted, Otter Tail, Pennington, Pine, Pipestone, Polk, Pope, Ramsey, Red Lake, Redwood, Renville, Rice, Rock, Roseau, St. Louis, Scott, Sherburne, Sibley, Stearns, Stevens, Swift, Todd, Wabasha, Wadena, Waseca, Washington, Watonwan, Winona, Wright, Yellow Medicine.

Mississippi

Counties of Alcorn, Amite, Attala, Benton, Bolivar, Calhoun, Carroll, Chickasaw, Choctaw, Claiborne, Clarke, Clay, Coahoma, Copiah, Covington, DeSoto, Forrest, Franklin, George, Greene, Grenada, Hinds, Holmes, Humphreys, Issaquena, Itawamba, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lafayette, Lamar, Lauderdale, Lawrence, Leake, Lee, Leflore, Lincoln, Lowndes, Madison, Marion, Marshall, Monroe, Montgomery, Neshoba, Newton, Noxubee, Oktibbeha, Panola, Perry, Pike, Pontotoc, Prentiss, Quitman, Rankin, Scott, Sharkey, Simpson, Smith, Sunflower, Tallahatchie, Tate, Tippah, Tishomingo, Tunica, Union, Walthall, Warren, Washington, Wayne, Webster, Winston, Yalobusha, Yazoo.

Missouri

Counties of Barton, Bates, Benton, Bollinger, Butler, Camden, Cape Girardeau, Carter, Cass, Cedar, Cooper, Crawford, Dade, Dallas, Dent, Dunklin, Franklin, Greene, Henry, Hickory, Iron, Jackson, Jasper, Jefferson, Johnson, Laclede, Lafayette, Lawrence, Madison, Miller, Mississippi, Moniteau, Morgan, New Madrid, Newton, Pemiscot, Perry, Pettis, Polk, Reynolds, Ripley, St. Clair, St. Francois, Ste. Genevieve, Saline, Scott, Shannon, Stoddard, Vernon, Washington, Wayne.

Montana

Counties of Beaverhead, Big Horn, Blaine, Broadwater, Carbon, Carter, Cascade, Chouteau, Custer, Daniels, Dawson, Deer Lodge, Fallon, Fergus, Flathead, Gallatin, Garfield, Glacier, Golden Valley, Granite, Hill, Jefferson, Judith Basin, Lake, Lewis and Clark, Liberty, Lincoln, Madison, McCone, Meagher, Mineral, Missoula, Musselshell, Park, Petroleum, Phillips, Pondera, Powder River, Powell, Prairie, Ravalli, Richland, Roosevelt, Rosebud, Sanders, Sheridan, Silver Bow, Stillwater, Sweet Grass, Teton, Toole, Treasure, Valley, Wheatland, Wibaux, Yellowstone.

Nebraska

Counties of Antelope, Arthur, Banner, Blaine, Box Butte, Boyd, Brown, Buffalo, Cedar, Chase, Cherry, Cheyenne, Custer, Dawes, Dawson, Deuel, Dixon, Dundy, Frontier, Furnas, Garden, Garfield, Gosper, Grant, Greeley, Hayes, Hitchcock, Holt, Hooker, Howard, Keith, Keya Paha, Kimball, Knox, Lincoln, Logan, Loup, McPherson, Morrill, Perkins, Pierce, Red Willow, Rock, Scotts Bluff, Sheridan, Sherman, Sioux, Thomas, Valley, Wheeler.

Nevada

Carson City. Counties of Churchill, Clark, Douglas, Elko, Esmeralda, Eureka, Humboldt, Lander, Lincoln, Lyon, Mineral, Nye, Pershing, Storey, Washoe, White Pine.

New Mexico

Counties of Catron, Cibola, McKinley, San Juan.

North Carolina

Counties of Alamance, Alexander, Alleghany, Anson, Ashe, Avery, Beaufort, Bertie, Bladen, Brunswick, Buncombe, Burke, Cabarrus, Caldwell, Caswell, Catawba, Chatham, Cherokee, Clay, Cleveland, Columbus, Cumberland, Davidson, Davie, Duplin, Durham, Edgecombe, Forsyth, Franklin, Gaston, Graham, Granville, Greene, Guilford, Halifax, Harnett, Haywood, Henderson, Hoke, Iredell, Jackson, Johnston, Jones, Lee, Lenoir, Lincoln, Macon, Madison, Martin, McDowell, Mecklenburg, Mitchell, Montgomery, Moore, Nash, New Hanover, Onslow, Orange, Pender, Person, Pitt, Polk, Randolph, Richmond, Robeson, Rockingham, Rowan, Rutherford, Sampson, Scotland, Stanly, Surry, Swain, Transylvania, Union, Vance, Wake, Warren, Watauga, Wayne, Wilkes, Wilson, Yadkin, Yancey.

North Dakota

Counties of Adams, Billings, Bottineau, Bowman, Burke, Cavalier, Divide, Emmons, Golden Valley, Grant, Hettinger, McHenry, McIntosh, McKenzie, Morton, Mountrail, Pembina, Renville, Rolette, Sioux, Slope, Stark, Towner, Walsh, Ward, Williams.

Ohio

Counties of Adams, Auglaize, Brown, Butler, Clermont, Clinton, Darke, Fayette, Gallia, Greene, Hamilton, Highland, Jackson, Lawrence, Meigs, Mercer, Miami, Montgomery, Paulding, Pike, Preble, Ross, Scioto, Shelby, Van Wert, Vinton, Warren.

Oklahoma

Counties of Alfalfa, Atoka, Beaver, Beckham, Blaine, Bryan, Caddo, Canadian, Carter, Choctaw, Cleveland, Coal, Comanche, Cotton, Craig, Creek, Custer, Delaware, Dewey, Ellis, Garfield, Garvin, Grady, Grant, Greer, Harmon, Harper, Haskell, Hughes, Jackson, Jefferson, Johnston, Kay, Kingfisher, Kiowa, Latimer, Le Flore, Lincoln, Logan, Love, Major, Marshall, Mayes, McClain, McCurtain, McIntosh, Murray, Muskogee, Noble, Nowata, Okfuskee, Oklahoma, Okmulgee, Osage, Ottawa, Pawnee, Payne, Pittsburg, Pontotoc, Pottawatomie, Pushmataha, Roger Mills, Rogers, Seminole, Sequoyah, Stephens, Tillman, Tulsa, Wagoner, Washington, Washita, Woods, Woodward.

Oregon

Counties of Baker, Grant, Harney, Lake, Malheur, Umatilla, Union, Wallowa.

South Carolina

Counties of Abbeville, Aiken, Allendale, Anderson, Bamberg, Barnwell, Beaufort, Berkeley, Calhoun, Charleston, Cherokee, Chester, Chesterfield, Clarendon, Colleton, Darlington, Dillon, Dorchester, Edgefield, Fairfield, Florence, Greenville, Greenwood, Hampton, Horry, Jasper, Kershaw, Lancaster, Laurens, Lee, Lexington, Marion, Marlboro, McCormick, Newberry, Oconee, Orangeburg, Pickens, Richland, Saluda, Spartanburg, Sumter, Union, Williamsburg, York.

South Dakota

Counties of Beadle, Bennett, Bon Homme, Brookings, Brule, Buffalo, Butte, Campbell, Charles Mix, Clark, Clay, Codington, Corson, Custer, Davison, Deuel, Dewey, Douglas, Edmunds, Fall River, Faulk, Grant, Gregory, Haakon, Hamlin, Hand, Hanson, Harding, Hughes, Hutchinson, Hyde, Jackson, Jones, Kingsbury, Lake, Lawrence, Lincoln, Lyman, McCook, McPherson, Meade, Mellette, Miner, Minnehaha, Moody, Pennington, Perkins, Potter, Roberts, Sanborn, Shannon, Stanley, Sully, Todd, Tripp, Turner, Union, Walworth, Yankton, Ziebach.

Tennessee

Counties of Anderson, Bedford, Benton, Bledsoe, Blount, Bradley, Campbell, Cannon, Carroll, Carter, Cheatham, Chester, Claiborne, Clay, Cocke, Coffee, Crockett, Cumberland, Davidson, Decatur, DeKalb, Dickson, Dyer, Fayette, Fentress, Franklin, Gibson, Giles, Grainger, Greene, Grundy, Hamblen, Hamilton, Hancock, Hardeman, Hardin, Hawkins, Haywood, Henderson, Henry, Hickman, Houston, Humphreys, Jackson, Jefferson, Johnson, Knox, Lake, Lauderdale, Lawrence, Lewis, Lincoln, Loudon, Macon, Madison, Marion, Marshall, Maury, McMinn, McNairy, Meigs, Monroe, Montgomery, Moore, Morgan, Obion, Overton, Perry, Pickett, Polk, Putnam, Rhea, Roane, Robertson, Rutherford, Scott, Sequatchie, Sevier, Shelby, Smith, Stewart, Sullivan, Sumner, Tipton, Trousdale, Unicoi, Union, Van Buren, Warren, Washington, Wayne, Weakley, White, Williamson, Wilson.

Texas

Counties of Anderson, Angelina, Archer, Atascosa, Austin, Bandera, Bastrop, Baylor, Bee, Bell, Bexar, Blanco, Bosque, Bowie, Brazos, Brewster, Brooks, Brown, Burleson, Burnet, Caldwell, Callahan, Cameron, Camp, Cass, Cherokee, Clay, Coke, Coleman, Collin, Collingsworth, Comal, Comanche, Concho, Cooke, Coryell, Crane, Crockett, Dallas, Delta, Denton, DeWitt, Dimmit, Duval, Eastland, Edwards, Ellis, Erath, Falls, Fannin, Fayette, Fisher, Foard, Franklin, Freestone, Frio, Gillespie, Glasscock, Goliad, Gonzales, Grayson, Gregg, Grimes, Guadalupe, Hamilton, Hardeman, Harrison, Haskell, Hays, Hemphill, Henderson, Hidalgo, Hill, Hood, Hopkins, Houston, Hunt, Irion, Jack, Jim Hogg, Jim Wells, Johnson, Jones, Karnes, Kaufman, Kendall, Kerr, Kimble, Kinney, Kleberg, Knox, La Salle, Lamar, Lampasas, Lavaca, Lee, Leon, Limestone, Lipscomb, Live Oak, Llano, Madison, Marion, Mason, Maverick, McCulloch, McLennan, McMullen, Medina, Menard, Milam, Mills, Montague, Montgomery, Morris, Nacogdoches, Navarro, Nolan, Nueces, Palo Pinto, Panola, Parker, Pecos, Polk, Presidio, Rains, Reagan, Real, Red River, Robertson, Rockwall, Runnels, Rusk, Sabine, San Augustine, San Jacinto, San Patricio, San Saba, Schleicher, Shackelford, Shelby, Smith, Somervell, Starr, Stephens, Sterling, Stonewall, Sutton, Tarrant, Taylor, Terrell, Throckmorton, Titus, Tom Green, Travis, Trinity, Upshur, Upton, Uvalde, Val Verde, Van Zandt, Walker, Washington, Webb, Wheeler, Wichita, Wilbarger, Willacy, Williamson, Wilson, Wise, Wood, Young, Zapata, Zavala.

Utah

Counties of Beaver, Box Elder, Cache, Carbon, Daggett, Davis, Duchesne, Emery, Garfield, Grand, Iron, Juab, Kane, Millard, Morgan, Piute, Rich, Salt Lake, San Juan, Sanpete, Sevier, Summit, Tooele, Uintah, Utah, Wasatch, Washington, Wayne, Weber.

Virginia

Cities of Alexandria, Bristol, Fairfax, Falls Church, Fredericksburg, Galax, Hampton, Manassas, Manassas Park, Newport News, Norfolk, Norton, Poquoson, Virginia Beach, Williamsburg, Winchester. Counties of Accomack, Arlington, Bland, Buchanan, Caroline, Carroll, Clarke, Culpeper, Dickenson, Essex, Fairfax, Fauquier, Frederick, Gloucester, Grayson, James City, King and Queen, King George, King William, Lancaster, Lee, Loudoun, Madison, Mathews, Middlesex, New Kent, Northampton, Northumberland, Orange, Prince William, Rappahannock, Richmond, Russell, Scott, Smyth, Spotsylvania, Stafford, Tazewell, Warren, Washington, Westmoreland, Wise, Wythe, York.

Washington

Counties of Asotin, Columbia, Garfield, Pend Oreille, Spokane, Stevens, Whitman.

West Virginia

Counties of Berkeley, Boone, Cabell, Jackson, Jefferson, Kanawha, Lincoln, Logan, Mason, McDowell, Mercer, Mingo, Putnam, Roane, Wayne.

Wisconsin

Counties of Ashland, Bayfield, Burnett, Door, Douglas, Florence, Forest, Iron, Langlade, Lincoln, Marinette, Menominee, Oconto, Oneida, Pierce, Polk, Price, St. Croix, Sawyer, Vilas, Washburn.

Wyoming

Counties of Albany, Big Horn, Campbell, Carbon, Converse, Crook, Fremont, Goshen, Hot Springs, Johnson, Laramie, Lincoln, Natrona, Niobrara, Park, Platte, Sheridan, Sublette, Sweetwater, Teton, Uinta, Washakie, Weston.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

S Corporation Guidance Under AJCA of 2004 and GOZA of 2005

REG–143326–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding certain changes made to the rules governing S corporations under the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005. The proposed regulations are necessary to replace obsolete references in the current regulations and to allow taxpayers to make proper use of the provisions that made changes to prior law. In particular, the proposed regulations provide guidance on the S corporation family shareholder rules, the definitions of "powers of appointment" and "potential current beneficiaries" (PCBs) with regard to electing small business trusts (ESBTs), the allowance of suspended losses to the spouse or former spouse of an S corporation shareholder, and relief for inadvertently terminated or invalid qualified subchapter S subsidiary (QSub) elections. The proposed regulations will affect S corporations and their shareholders. This document also provides a notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 27, 2007. Outlines of topics to be discussed at the public hearing scheduled for January 16, 2008, at 10 a.m., must be received by December 27, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–143326–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–143326–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (indicate IRS REG–143326–05). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W. Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Bradford R. Poston, (202) 622–3060; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by November 27, 2007.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The reporting requirement in these proposed regulations is in §1.1361–1(m)(2)(ii)(A). This information must be reported by the trustees of trusts electing to be ESBTs. This information will be used by the IRS to determine the number of shareholders of the corporation in which the trust holds stock and thus whether the corporation is an eligible S corporation. The respondents will be trusts making an ESBT election.

The following estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on the information that is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

Estimated total annual reporting burden: 26,000 hours.

Estimated average annual burden: 1 hour.

Estimated number of respondents: 26,000.

Estimated annual frequency of response: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regu-

lations (26 CFR part 1) concerning S corporations under sections 1361, 1362, and 1366 of the Internal Revenue Code (Code). These Code sections were amended by sections 231, 232, 233, 234, 235, 236, 237, 238, and 239 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418) (the 2004 Act) and sections 403 and 413 of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135) (the 2005 Act). This document does not address other amendments made by the 2004 Act or the 2005 Act. In addition, this document contains additional proposed amendments to the regulations under Code section 1362 necessary to conform the regulations to the changes made by section 1305(a) of the Small Business Job Protection Act of 1996 (Public Law 104–188, 110 Stat. 1755) (the 1996 Act).

Explanation of Provisions

Increase in Maximum Number of Shareholders

Section 232 of the 2004 Act amends Code section 1361(b)(1)(A) by increasing the permitted number of shareholders from 75 to 100 for a small business corporation eligible to make an S election. This provision is effective for taxable years beginning after December 31, 2004. The proposed regulations remove or amend several references in the regulations under Code section 1361 that cite a specific number of permissible S corporation shareholders, except insofar as such references are necessary in an example. This change will accommodate any future statutory changes in the maximum number of permitted shareholders.

Family Shareholders

Section 1361(c)(1), as amended by section 231(a) of the 2004 Act and section 403(b) of the 2005 Act, treats a husband and wife (and their estates), and all members of a family (and their estates) as one shareholder for purposes of the 100 shareholder limitation. Section 403(b) of the 2005 Act eliminated the requirement of an election in order for a family to be treated as one shareholder, providing instead that members of a family would automatically be treated as one shareholder for purposes of Code section 1361(b)(1)(A). This amendment is effective as if included in section 231 of the 2004 Act for tax years beginning after December 31, 2004. Notice 2005–91, 2005–2 C.B. 1164, *see* § 601.601(d)(2)(ii)(*b*), issued prior to the enactment of section 403(b) of the 2005 Act, informed taxpayers that the Treasury Department and the IRS intended to issue guidance regarding the family shareholder election under section 1361(c) and provided that taxpayers could rely on the provisions of Notice 2005–91 until the issuance of that guidance. Although the portions of Notice 2005–91 addressing the manner of making the family shareholder election are no longer relevant, the proposed regulations retain the provisions of Notice 2005–91 describing certain entities other than individuals that will be treated as members of the family.

The family members are determined by reference to a common ancestor. Section 1361(c)(1)(B) defines "members of a family" as a common ancestor, any lineal descendant of the common ancestor, and any spouse or former spouse of the common ancestor or any such lineal descendant. Adopted and foster children are included among the lineal descendants as described in section 1361(c)(1)(C). An individual is not eligible to be the common ancestor for purposes of this provision if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders who would otherwise be members of the family (without regard to the "six generation" test of Code section 1361(c)(1)(B)(ii)). Section 403(b) of the 2005 Act also changed the applicable date in section 1361(c)(1)(B)(iii) on which a person will be tested for qualification as a "common ancestor" to the latest of (1) the date the S election is made, (2) the earliest date an individual who is a "member of the family" holds stock in the S corporation, or (3) October 22, 2004. The regulation clarifies that the "six generation" test is applied only at the date specified in Code section 1361(c)(1)(B)(iii) for determining whether an individual meets the definition of "common ancestor," and has no continuing significance in limiting the number of generations of a family that may hold stock and be treated as a single shareholder. The regulation provides that there is no adverse consequence to a person being a member of two families.

Disregard of Unexercised Powers of Appointment in ESBTs

Potential current beneficiaries (PCBs) are treated as shareholders of the corporation for purposes of Code section 1361(b)(1) (which addresses both shareholder eligibility and the permitted number of shareholders). Section 234 of the 2004 Act amended Code section 1361(e)(2) by providing that in determining an ESBT's PCBs for any period, powers of appointment will be disregarded to the extent not exercised by the end of that period. The amended section also increases the period from 60 days to one year during which an ESBT may safely dispose of S corporation stock after an ineligible shareholder becomes a PCB. These amendments apply to taxable years beginning after December 31, 2004.

The amendment overrides current §1.1361–1(m)(4)(vi) and the illustrative example which provide that any person who may receive a distribution under a currently exercisable power of appointment is a PCB. Under §1.1361–1(m)(4)(vi), the broad powers of appointment commonly included in many trusts used for estate planning purposes would preclude those trusts from qualifying as ESBTs, because that power would cause the S corporation to have an excessive number of deemed shareholders or to have as deemed shareholders persons ineligible to hold S corporation stock. The proposed regulations remove and replace the sections of the regulation inconsistent with current law.

The Treasury Department and the IRS have received inquiries concerning whether certain powers held by a trustee or any other person who is not a beneficiary will be considered to be powers of appointment for purposes of Code section 1361(e)(2), and thus be disregarded (to the extent not exercised) in determining the PCBs of the ESBT. In particular, there is concern about the powers to add persons to the class of current beneficiaries or to select from an unlimited class of charitable beneficiaries. Under the current regulations, such powers, regardless of the identity of the holder, could result in the termination of the S corporation election if the class of charities that could currently receive distributions or the class of persons who could be added as bene-

ficiaries is sufficiently large to cause the corporation to have more than the number of shareholders allowed by Code section 1361(b)(1)(A).

"Power of appointment" is not defined or described in either Code section 1361(e)(2) as amended or in current §1.1361–1(m). However, "power of appointment" is described for estate tax purposes in §20.2041–1(b) of the Estate Tax Regulations and for gift tax purposes in §25.2514–1(b) of the Gift Tax Regulations. For transfer tax purposes, a power of appointment generally includes the power to appropriate or consume the principal of the trust or the power to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust.

If the transfer tax descriptions are narrowly interpreted, powers held by fiduciaries (who are not also beneficiaries of the trust) to spray or sprinkle trust distributions would generally not be "powers of appointment." Therefore, the relief provided by the amended provision of Code section 1361(e)(2) would not apply to prevent the possible creation of an excessive number of PCBs. These powers would continue to be treated under the general rule of current §1.1361–1(m)(4)(i), which provides that a PCB "is, with respect to any period, any person who at any time during such period is entitled to, or in the discretion of any person may receive, a distribution from the principal or income of the trust." Any sufficiently broad power to spray or sprinkle trust distributions would result in an excessive number of PCBs and thus cause the termination of the S corporation election.

Alternatively, if all fiduciary powers to spray or sprinkle trust distributions to a class of current beneficiaries or possible current beneficiaries were deemed to be "powers of appointment" for purposes of Code section 1361(e)(2), this would effectively result in the replacement of "potential current beneficiaries" as a measuring tool under Code section 1361(b)(1) with "current beneficiaries," as only those actually receiving distributions would ever meet the PCB definition. The 2004 Act, however, did not replace "potential current beneficiary" with "current beneficiary".

The Treasury Department and the IRS believe that the proper interpretation of the change made by the 2004 Act is that the provision avoids counting as PCBs an unlimited number of potential appointees who may never become permissible beneficiaries. In this manner, the legislative change prevents the mere presence of common estate planning powers in a trust instrument from resulting in a termination of the S corporation election because of an excessive number of PCBs. The power to select from among an unlimited class of charities within the class of beneficiaries who may receive current distributions from a trust in the discretion of a fiduciary is a common estate planning power.

The proposed regulations amend the definition of "potential current beneficiary" to provide that all members of a class of unnamed charities permitted to receive distributions under a discretionary distribution power held by a fiduciary that is not a power of appointment, will be considered, collectively, to be a single PCB for purposes of determining the number of permissible shareholders under section 1361(b)(1)(A) unless the power is actually exercised, in which case each charity that actually receives distributions will also be a PCB. The ESBT election requirements under §1.1361–1(m)(2)(ii)(A) are amended to require a trust containing such a power to indicate the presence of the power in the election statement. This amended PCB definition applies only to powers to distribute to one or more members of a class of unnamed charities which is unlimited in number. The amended PCB definition does not apply to a power to make distributions to or among particular named charities.

The proposed regulations further provide that a power to add beneficiaries, whether or not charitable, to a class of current permissible beneficiaries is generally a power of appointment and thus will be disregarded to the extent it is not exercised. However, if the power is exercised and an unlimited class of charitable beneficiaries is added to the class of current permissible beneficiaries, that class will count as a single PCB under the amended definition of PCB, and, to the extent distributions are actually made to one or more charities, those charities will each count as PCBs.

Transfer of Stock Between Spouses or Incident to Divorce

Section 235 of the 2004 Act amended Code section 1366(d)(2) to provide that if the stock of an S corporation is transferred between spouses or incident to divorce under Code section 1041(a), any loss or deduction with respect to the transferred stock which cannot be taken into account by the transferring shareholder in the year of the transfer because of the basis limitation in section 1366(d)(1) shall be treated as incurred by the corporation in the succeeding taxable year with regard to the transferee. Prior to this amendment, any losses or deductions disallowed under section 1366(d) were personal to the shareholder and did not transfer upon the transfer of the S corporation stock to another person. Section 1366(d)(2) is effective for transfers after December 31, 2004.

The proposed regulations amend the provisions of §1.1366–2(a)(5) to include this exception to the general rule of nontransferability of losses and deductions. Losses and deductions allocable to the transferor spouse for the taxable year immediately preceding the year of transfer that are subject to the basis limitation rule of section 1366(d) will be treated as incurred by the corporation with respect to the transferor spouse in the taxable year of the transfer. The transferor spouse may use all losses and deductions carried over to the year of transfer if the transferor spouse has sufficient basis in the transferor's adjusted basis in stock or adjusted basis in the indebtedness of the corporation to the transferor. Under §1.1366–2(a)(4), if the transferor's *pro rata* share of the losses and deductions in the year of transfer exceeds the transferor's basis in stock or the indebtedness of the corporation to the transferor, then the limitation must be allocated among the transferor spouse's *pro rata* share of each loss or deduction, including disallowed losses and deductions carried over from the prior year. Under the proposed regulations, losses and deductions carried over to the year of transfer that are not used by the transferor spouse in such year will be prorated between the transferor spouse and the transferee spouse based on their stock ownership at the beginning of the succeeding taxable year. The proposed regulations include examples illustrating these rules. The Treasury

Department and IRS request comments on the best methods to ensure that losses are properly allocated between the transferor and transferee spouses, including whether a notification requirement should be imposed on the transferor spouse.

Passive Activity Losses and At-risk Amounts of Qualified Subchapter S Trusts

Section 236 of the 2004 Act amends Code section 1361(d)(1) to provide that, for purposes of applying Code sections 465 and 469 to the beneficiary of a qualified subchapter S trust (QSST) with respect to which the beneficiary has made an election under Code section 1361(d)(2), the disposition of S corporation stock by the QSST shall be treated as a disposition by the beneficiary. This creates an exception to the general rule of §1.1361–1(j)(8), which provides that the trust, rather than the beneficiary, is treated as the owner of the S corporation stock in determining the income tax consequences of a disposition of the stock. The proposed regulations add conforming language to §1.1361–1(j)(8).

Qualified Subchapter S Subsidiary Relief and Inadvertent Invalid Elections or Terminations

Section 238 of the 2004 Act amends Code section 1362(f) to provide that QSubs are eligible for relief for an inadvertent invalid QSub election or termination under the same standards applied to an inadvertent invalid S corporation election or termination. This provision is effective for elections made and terminations occurring after December 31, 2004. The proposed regulations make conforming changes to §1.1362–4. The proposed regulations make additional changes to §1.1362–4 addressing the change to Code section 1362(f) made by section 1305(a) of the 1996 Act, which provided relief for corporations with inadvertently invalid S corporation elections, in addition to the relief already available for inadvertent terminations of valid S corporation elections.

Effect on Other Documents

The following publication is proposed to be obsoleted as of the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**:

Notice 2005–91, 2005–2 C.B. 1164.

Proposed Effective Date

These regulations are proposed to be effective on the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Further, it has been determined that these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6) because the collection of information required by these regulations is imposed on electing small business trusts and such entities are not "small entities" for purposes of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Additionally, the information collection burden imposed on the electing small business trusts is minimal. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 16, 2008, beginning at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 27, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Bradford R. Poston of the Office of Associate Chief Counsel (Passthroughs and Special Industries).

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Proposed Amendment to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1361–0 is amended by adding a new entry in the table of contents for §1.1361–1(e)(3) to read as follows:

§1.1361–0 Table of contents.

* * * * *

§1.1361–1 S Corporation defined.

* * * * *

(e) * * *

(3) Special rules relating to stock owned by members of a family.

Par. 3. Section 1.1361–1 is amended by:

1. Revising paragraphs (b)(1)(i) and (e)(1).

2. Adding paragraphs (e)(3), (h)(1)(vii), and (h)(3)(i)(G).

3. Adding a new sentence to the end of paragraph (j)(8).

4. Adding a new sentence to the end of paragraph (k)(2)(i).

5. Revising paragraphs (m)(2)(ii)(A), (m)(4)(iii), and (m)(4)(vi).

6. Revising paragraph (m)(8), *Example 2.*

7. Revising the seventh sentence of paragraph (m)(8), *Example 5.*

8. Revising paragraph (m)(8), *Example 7.*

9. Adding paragraph (m)(8), *Example 8.*

10. Adding paragraph (m)(8), *Example 9.*

11. Adding a sentence to the end of paragraph (m)(9).

The revisions and additions read as follows:

§1.1361–1 S Corporation defined.

* * * * *

(b) * * * (1) * * *

(i) More than the number of shareholders provided in section 1361(b)(1)(A);

* * * * *

(e) Number of shareholders—(1) *General rule.* A corporation does not qualify as a small business corporation if it has more than the number of shareholders provided in section 1361(b)(1)(A). Ordinarily, the person who would have to include in gross income dividends distributed with respect to the stock of the corporation (if the corporation were a C corporation) is considered to be the shareholder of the corporation. For example, if stock (owned other than by a husband and wife or members of a family described in section 1361(c)(1)) is owned by tenants in common or joint tenants, each tenant in common or joint tenant is generally considered to be a shareholder of the corporation. (For special rules relating to stock owned by husband and wife or members of a family, see paragraphs (e)(2) and (3) of this section, respectively; for special rules relating to restricted stock, see paragraphs (b)(3) and (6) of this section.) The person for whom stock of a corporation is held by a nominee, guardian, custodian, or an agent is considered to be the shareholder of the corporation for purposes of this paragraph (e) and paragraphs (f) and (g) of this section. For example, a partnership may be a nominee of S corporation stock for a person who qualifies as a shareholder of an S corporation. However, if the partnership is the beneficial owner of the stock, then the partnership is the shareholder, and the corporation does not qualify as a small business corporation. In addition, in the case of stock held for a minor under a uniform transfers to minors or similar statute, the minor and not the custodian is the shareholder. Except as otherwise provided in paragraphs (h) and (j) of this section, and for purposes of this paragraph (e) and paragraphs (f) and (g) of this section, if stock is held by a decedent's estate or a trust described in section 1361(c)(2)(A)(ii) or (iii), the estate or trust (and not the beneficiaries of the estate or trust) is considered to be the shareholder; however, if stock is held by a subpart E trust (which includes a voting trust) or an electing QSST described in section 1361(d)(1), the deemed owner of the trust is considered to be the shareholder. If stock is held by an ESBT described in section 1361(c)(2)(A)(v), each potential current beneficiary of the trust shall be treated as a shareholder, except that the trust shall be treated as the shareholder during any period in which there is no potential current beneficiary of the trust. If stock is held by a trust described in section 1361(c)(2)(A)(vi), the individual for whose benefit the trust was created shall be treated as the shareholder. See paragraph (h) of this section for special rules relating to trusts.

* * * * *

(3) *Special rules relating to stock owned by members of a family*—(i) *In general.* For purposes of paragraph (e)(1) of this section, stock owned by members of a family is treated as owned by one shareholder. Members of a family include a common ancestor, any lineal descendant of the common ancestor, and any spouse (or former spouse) of the common ancestor or of any lineal descendants of the common ancestor. An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than six generations removed from the youngest generation of shareholders who would (but for this six-generation test) be members of the family. For purposes of this test, a spouse (or former spouse) is treated as being of the same generation as the individual to whom the spouse is or was married. This test is applied on the latest of the date the election under section 1362(a) is made for the corporation, the earliest date that a member of the family holds stock in the corporation, or October 22, 2004. For this purpose, the date the election under section 1362(a) is made for the corporation is the effective date of the election, not the date it is signed or received by any person. The test is only applied as of the applicable date, and lineal descendants (and spouses) more than six generations removed from the common ancestor will be treated as members of the family even if they acquire stock in the corporation after that date. The members of a family are treated as one shareholder under this paragraph (e)(3) solely for purposes of section 1361(b)(1)(A), and not for any other purpose, whether under section 1361 or any other provision. Specifically, each member of the family who owns or is deemed to own stock must meet the requirements of sections 1361(b)(1)(B) and (C) (regarding permissible shareholders) and section 1362(a)(2) (regarding shareholder consents to an S corporation election). Although a person may be a member of more than one family under this paragraph (e)(3), each family (not all of whose members are also members of the other family) will be treated as one shareholder. For purposes of this paragraph (e)(3), any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by that individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

(ii) *Certain entities treated as members of a family.* For purposes of this paragraph (e)(3), the estate or trust (described in section 1361(c)(2)(A)(ii) or (iii)) of a deceased member of the family will be considered to be a member of the family during the period in which the estate or such trust (if the trust is described in section 1361(c)(2)(A)(ii) or (iii)), holds stock in the S corporation. The members of the family also will include—

(A) In the case of an ESBT, each potential current beneficiary who is a member of the family;

(B) In the case of a QSST, the income beneficiary who makes the QSST election, if that income beneficiary is a member of the family;

(C) In the case of a trust created primarily to exercise the voting power of stock transferred to it, each beneficiary who is a member of the family;

(D) The individual for whose benefit a trust described in section 1361(c)(2)(A)(vi) was created, if that individual is a member of the family;

(E) The deemed owner of a trust described in section 1361(c)(2)(A)(i) if that deemed owner is a member of the family; and

(F) The owner of an entity disregarded as an entity separate from its owner under §301.7701–3 of the Procedure and Administration Regulations, if that owner is a member of the family.

* * * * *

(h)* * * (1)* * *

(vii) *Individual retirement accounts*. In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of October 22, 2004. Individual retirement accounts (including Roth IRAs) are not otherwise eligible S corporation shareholders.

* * * * *

(3)* * * (i) * * *

(G) If stock in an S corporation bank or depository institution holding company is held by an individual retirement account (including a Roth IRA) described in paragraph (h)(1)(vii) of this section, the individual for whose benefit the trust was created shall be treated as the shareholder.

* * * * *

(j)* * *

(8)* * * However, solely for purposes of applying sections 465 and 469 to the income beneficiary, a disposition of S corporation stock by a QSST shall be treated as a disposition by the income beneficiary.

* * * * *

(k)* * *(2) * * *

(i) * * * Paragraphs (b)(1)(i), (e)(1), (e)(3), (h)(1)(vii), (h)(3)(i)(G), and the fifth sentence of paragraph (j)(8) are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

(m)* * *(2)* * *

(ii)* * *

(A) The name, address, and taxpayer identification number of the trust, the potential current beneficiaries, and the S corporations in which the trust currently holds stock. If the trust includes a power described in paragraph (m)(4)(vi)(B) of this section, then the election statement must include a statement that such a power is included in the instrument, but does not need to include the name, address, or taxpayer identification number of any particular charity or any other information regarding the power.

* * * * *

(4)* * *

(iii) *Special rule for dispositions of stock.* Notwithstanding the provisions of paragraph (m)(4)(i) of this section, if a trust disposes of all of the stock which it holds in an S corporation, then, with respect to that corporation, any person who first met the definition of a potential current beneficiary during the 1-year period ending on the date of such disposition is not a potential current beneficiary and thus is not a shareholder of that corporation.

* * * * *

(vi) *Currently exercisable powers of appointment and other powers*—(A) *Powers of appointment.* A person to whom a distribution may be made during any period pursuant to a power of appointment (as described for transfer tax purposes in section 2041 and §20.2041–1(b) of this chapter and section 2514 and §25.2514–1(b) of this chapter) is not a potential current beneficiary unless the power is exercised in favor of that person during the period. It is immaterial for purposes of this paragraph (m)(4)(vi)(A) whether such power of appointment is a "general power of appointment" for transfer tax purposes as described in §20.2041–1(c) and §25.2514–1(c) of this chapter. The mere existence of one or more powers of appointment during the lifetime of a power holder that would permit current distributions from the trust to be made to more than the number of persons described in section 1361(b)(1)(A) or to a person described in section 1361(b)(1)(B) or (C), will not cause the S corporation election to terminate unless one or more of such powers are exercised, collectively, in favor of an excessive number of persons or in favor of a person who is ineligible to be an S corporation shareholder. For purposes of this paragraph (m)(4)(vi)(A), a "power of appointment" includes a power, regardless of by whom held, to add a beneficiary or class of beneficiaries to the class of potential current beneficiaries, but generally does not include a power held by a fiduciary who is not also a beneficiary of the trust to spray or sprinkle trust distributions among beneficiaries. Nothing in this paragraph (m)(4)(vi)(A) alters the definition of "power of appointment" for purposes of any provision of the Internal Revenue Code or the regulations.

(B) *Powers to distribute to certain organizations not pursuant to powers of appointment.* If a trustee or other fiduciary has a power (that does not constitute a power of appointment for transfer tax purposes as described in §§20.2041–1(b) and 25.2514–1(b) of this chapter) to make distributions from the trust to one or more members of a class of organizations described in section 1361(c)(6), such organizations will be counted collectively as only one potential current beneficiary for purposes of this paragraph (m), except that each organization receiving a distribution also will be counted as a potential current beneficiary. This paragraph (m)(4)(vi)(B) shall not apply to a power to currently distribute to one or more particular charitable organizations named in the instrument. Each of such organizations is a potential current beneficiary of the trust.

* * * * *

(8)* * *

Example 2. (i) *Invalid potential current beneficiary.* Effective January 1, 2005, Trust makes a valid ESBT election. On January 1, 2006, *A*, a nonresident alien, becomes a potential current beneficiary of Trust. Trust does not dispose of all of its S corporation stock within one year after January 1, 2006. As of January 1, 2006, *A* is the potential current beneficiary of Trust and therefore is treated as a shareholder of the S corporation. Because *A* is not an eligible shareholder of an S corporation under section 1361(b)(1), the S corporation election of any corporation in which Trust holds stock terminates effective January 1, 2006. Relief may be available under section 1362(f).

(ii) *Invalid potential current beneficiary and disposition of S stock.* Assume the same facts as in *Example 2* (i) except that within one year after January

1, 2006, trustee of Trust disposes of all Trust's S corporation stock. *A* is not considered a potential current beneficiary of Trust and therefore is not treated as a shareholder of any S corporation in which Trust previously held stock.

* * * * *

*Example 5.** * *Trust–2 itself will not be counted toward the shareholder limit of section 1361(b)(1)(A).* * *

* * * * *

Example 7. Potential current beneficiaries and powers of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. *A* also has a currently exercisable power to appoint income or principal to anyone except *A*, *A*'s creditors, *A*'s estate, and the creditors of *A*'s estate. The potential current beneficiaries of Trust for any period will be *A* and each person who receives a distribution from Trust pursuant to *A*'s exercise of *A*'s power of appointment during that period.

Example 8. Power to distribute to an unlimited class of charitable organizations not pursuant to a power of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not *A* or a descendant of *M*, has the power to make discretionary distributions of principal to the living descendants of *M* and to any organizations described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be *A*, each then-living descendant of *M*, and each exempt organization described in section 1361(c)(6) that receives a distribution during that period. In addition, the class of exempt organizations will be counted as one potential current beneficiary.

Example 9. Power to distribute to a class of named charitable organizations not pursuant to a power of appointment. M creates Trust from which *A* has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not *A* or a descendant of *M*, has the power to make discretionary distributions of principal to the living descendants of *M* and to *X*, *Y*, and *Z*, each of which is an organization described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be *A*, *X*, *Y*, *Z*, and each living descendant of *M*.

(9) *Effective/applicability date.* * * *

Paragraphs (m)(2)(ii)(A), (m)(4)(iii) and (vi), and (m)(8), *Example 2*, *Example 5*, *Example 7*, *Example 8*, and *Example 9* are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations is published in the **Federal Register**.

Par. 4. Section 1.1361–4 is amended by revising paragraph (a)(1) and adding new paragraph (a)(9) to read as follows:

§1.1361–4 Effect of QSub Election.

(a) *Separate existence ignored*—(1) *In general.* Except as otherwise provided in paragraphs (a)(3), (a)(6), (a)(7), (a)(8), and (a)(9) of this section, for Federal tax purposes—

(i) A corporation which is a QSub shall not be treated as a separate corporation; and

(ii) All assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

* * * * *

(9) *Information returns*—(i) *In general.* Except to the extent provided by the Secretary, paragraph (a)(1) of this section shall not apply to part III of subchapter A of chapter 61, relating to information returns.

(ii) *Effective/applicability date.* This paragraph (a)(9) is effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Par. 5. Section 1.1361–6 is amended by revising the first sentence as follows:

§1.1361–6 Effective date.

Except as provided in §§1.1361–4(a)(3)(iii), 1.1361–4(a)(5)(i), 1.1361–4(a)(6)(iii), 1.1361–4(a)(7)(ii), 1.1361–4(a)(8)(ii), 1.1361–4(a)(9), and 1.1361–5(c)(2), the provisions of §§1.1361–2 through 1.1361–5 apply to taxable years beginning on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part (aside from those sections with special dates of applicability), for taxable years beginning on or after January 1, 2000, provided all affected taxpayers apply the regulations in a consistent manner. * * *

Par. 6. Section 1.1362–0 is amended by revising the heading of the table of contents for §1.1362–4 to read as follows:

§1.1362–0 Table of contents.

* * * * *

§1.1362–4 Inadvertent terminations and inadvertently invalid elections.

* * * * *

Par. 7. Section 1.1362–4 is amended by:

1. Revising the section heading and paragraphs (a), (b), (c), (d), and (f).

2. Adding paragraph (g).

The addition and revisions read as follows:

§1.1362–4 Inadvertent terminations and inadvertently invalid elections

(a) *In general.* A corporation is treated as continuing to be an S corporation or a QSub (or, an invalid election to be either an S corporation or a QSub is treated as valid) during the period specified by the Commissioner if—

(1) The corporation made a valid election under section 1362(a) or section 1361(b)(3) and the election terminated or the corporation made an election under section 1362(a) or section 1361(b)(3) that was invalid;

(2) The Commissioner determines that the termination or invalidity was inadvertent;

(3) Steps were taken by the corporation to return to or qualify for small business corporation or QSub status within a reasonable period after discovery of the terminating event or invalid election, or the required shareholder consents are acquired; and

(4) The corporation and shareholders agree to adjustments that the Commissioner may require for the period.

(b) *Inadvertent termination or inadvertently invalid election.* For purposes of paragraph (a) of this section, the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

(c) *Corporation's request for determination of an inadvertent termination or invalid election.* A corporation that believes that the termination or invalidity of its election was inadvertent may request a

determination from the Commissioner that the termination or invalidity of its election was inadvertent. The request is made in the form of a ruling request and should set forth all relevant facts pertaining to the event or circumstance including, but not limited to, the facts described in paragraph (b) of this section, the date of the corporation's election (or intended election) under section 1362(a) or 1361(b)(3), a detailed explanation of the event or circumstance causing the termination or invalidity, when and how the event or circumstance was discovered, and the steps taken under paragraph (a)(3) of this section.

(d) *Adjustments*. The Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation or QSub during the period specified by the Commissioner. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under section 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

* * * * *

(f) *Status of corporation*. The status of the corporation after the terminating event or invalid election and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination or inadvertent invalid election relief may be granted retroactively for all years for which the terminating event or circumstance giving rise to invalidity is effective, in which case the corporation is treated as if its election was valid or had not terminated. Alternatively, relief may be granted only for the period in which the corporation became eligible for subchapter S or QSub treatment, in which case the corporation is treated as a C corporation or, in the case of a QSub with an inadvertently terminated or invalid election, as a separate C corporation, during the period for which the corporation was not eligible for its intended status.

(g) *Effective/applicability date*. Paragraphs (a), (b), (c), (d), and (f) of this section are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 8. Section 1.1366–0 is amended by adding new entries in the table of contents for §1.1366–2(a)(5)(i) through (iii) to read as follows:

§1.1366–0 Table of contents.

* * * * *

§1.1366–2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) * * *

(5) * * * (i) *In general.*

(ii) *Exceptions for transfers of stock under section 1041(a).*

(iii) *Examples.*

Par. 9. Section 1.1366–2(a)(5) is amended by:

1. Adding a heading and revising the first sentence of paragraph (a)(5)(i).

2. Adding paragraphs (a)(5)(ii) and (a)(5)(iii).

The revisions and additions read as follows:

§1.1366–2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) *In general.** * *

(5) *Nontransferability of losses and deductions*—(i) *In general.* Except as provided in paragraph (a)(5)(ii) of this section, any loss or deduction disallowed under paragraph (a)(1) of this section is personal to the shareholder and cannot in any manner be transferred to another person. * * *

(ii) *Exceptions for transfers of stock under section 1041(a).* If a shareholder transfers stock of an S corporation after December 31, 2004, in a transfer described in section 1041(a), any loss or deduction with respect to the transferred stock that is disallowed to the transferring shareholder under paragraph (a)(1) of this section shall be treated as incurred by the corporation in the following taxable year with respect to the transferee spouse or former spouse. The amount of any loss or deduction with respect to the stock transferred shall be determined by prorating any losses or deductions disallowed under paragraph (a)(1) for the year of the transfer between the transferor and the spouse or former spouse based on the stock ownership at the beginning of the following taxable year. If a transferor claims a deduction for losses in the taxable year of transfer, then under paragraph (a)(4) of this section, if the transferor's *pro rata* share of the losses and deductions in the year of transfer exceeds the transferor's basis in stock or the indebtedness of the corporation to the transferor, then the limitation must be allocated among the transferor spouse's *pro rata* share of each loss or deduction, including disallowed losses and deductions carried over from the prior year.

(iii) *Examples.* The following examples illustrates the provisions of paragraph (a)(5)(ii) of this section:

Example 1. A owns all 100 shares in *X*, a calendar year S corporation. For *X*'s taxable year ending December 31, 2006, *A* has zero basis in the shares and *X* does not have any indebtedness to *A*. For the 2006 taxable year, *X* had $100 in losses which *A* cannot use because of the basis limitation in section 1366(d)(1) and which are treated as incurred by the corporation with respect to *A* in the following taxable year. Halfway through the 2007 taxable year, *A* transfers 50 shares to *B*, *A*'s former spouse in a transfer to which section 1041(a) applies. In the 2007 taxable year, *X* has $80 in losses. On *A*'s 2007 individual income tax return, *A* may use the entire $100 carryover loss from 2006, as well as *A*'s share of the $80 2007 loss determined under section 1377(a) ($60), assuming *A* acquires sufficient basis in the *X* stock. On *B*'s 2007 individual income tax return, *B* may use *B*'s share of the $80 2007 loss determined under section 1377(a) ($20), assuming *B* has sufficient basis in the *X* stock. If any disallowed 2006 loss is disallowed to *A* under section 1366(d)(1) in 2007, that loss is prorated between *A* and *B* based on their stock ownership at the beginning of 2008. On *B*'s 2008 individual income tax return, *B* may use that loss, assuming *B* acquires sufficient basis in the *X* stock. If neither *A* nor *B* acquires any basis during the 2007 taxable year, then as of the beginning of 2008, the corporation will be treated as incurring $50 of loss with respect to *A* and $50 of loss with respect to *B* for the $100 of disallowed 2006 loss, and the corporation will be treated as incurring $60 of loss with respect to *A* and $20 with respect to *B* for the $80 of disallowed 2007 loss.

Example 2. Assume the same facts as *Example 1*, except that during the 2007 taxable year, *A* acquires $10 of basis in *A*'s shares in *X*. For the 2007 taxable year, *A* may claim a $10 loss deduction, which represents $6.25 of the disallowed 2006 loss of $100 and $3.75 of *A*'s 2007 loss of $60. The disallowed 2006 loss is reduced to $93.75. As of the beginning of 2008, the corporation will be treated as incurring half of the remaining $93.75 of loss with respect to *A* and half of that loss with respect to *B* for the remaining $93.75 of disallowed 2006 loss, and if *B* does not acquire any basis during 2007, the corporation will

be treated as incurring $56.25 of loss with respect to *A* and $20 with respect to *B* for the remaining disallowed 2007 loss.

* * * * *

Par. 10. Section 1.1366–5 is amended by adding a new sentence at the end.

The addition reads as follows:

§1.1366–5 Effective/applicability date.

* * * Paragraphs 1.1366–2(a)(5)(i), (ii) and (iii) are effective on and after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 27, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 28, 2007, 72 F.R. 55132)

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage Guidance for Tax-Exempt Bonds

REG–106143–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions under section 148 of the Internal Revenue Code applicable to tax-exempt bonds issued by State and local governments. These proposed regulations are being issued in order to update existing regulations to address certain current market developments, to simplify and correct certain provisions, and to make existing regulations more administrable. These proposed regulations affect State and local governmental issuers of tax-exempt bonds. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by December 26, 2007. Outlines of topics to be discussed at the public hearing scheduled for January 30, 2008, at 10 a.m., must be received by January 2, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–106143–07), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106143–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–106143–07). The public hearing will be held in the Main IRS Auditorium at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Carla Young, (202) 622–3980; concerning submissions of comments and the hearing, *Richard.A.Hurst@irscounsel.treas.gov*, or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code). On June 18, 1993, the Treasury Department and the Internal Revenue Service (IRS) published comprehensive final regulations in the **Federal Register** (T.D. 8476, 1993–2 C.B. 13 [58 FR 33510]) on the arbitrage investment restrictions and related provisions on tax-exempt bonds under sections 103, 148, 149, and section 150 of the Code, and, since that time, those final regulations have been amended in certain limited respects (the regulations issued in 1993 and the amendments thereto are collectively referred to as the Existing Regulations). The Treasury Department and the IRS have since determined that certain provisions in the Existing Regulations need to be modified. This document contains proposed discrete amendments to the Existing Regulations (the Proposed Regulations) to update the Existing Regulations to address certain current market developments, to simplify certain provisions in the Existing Regulations, to correct certain technical issues in the Existing Regulations, and to make the Existing Regulations more administrable.

In addition, the Treasury Department and the IRS are in the process of reviewing the Existing Regulations for future regulatory guidance on additional discrete issues for the same purposes.

Explanation of Provisions

I. *Existing Regulations*

Section 103(a) of the Code generally excludes from gross income interest on a State or local bond. Under section 103(b), however, the interest exclusion does not apply to an arbitrage bond, as defined in section 148. Section 148 provides two related, but independent types of restrictions to determine whether a bond is an arbitrage bond: a yield restriction requirement and an arbitrage rebate requirement. Generally, these restrictions limit the ability of an issuer to invest bond proceeds in investments at a yield that materially exceeds the yield on the bond issue and require that certain excess earnings above the yield on the bond issue be rebated to the Federal government. Investment earnings that exceed the yield on the bond issue are commonly referred to as arbitrage.

Under section 148(a) of the Code, the yield restriction requirement generally provides that a bond is an arbitrage bond if an issuer reasonably expects to earn arbitrage or if the issuer, subsequent to the issuance of the bonds, engages in a deliberate action to earn arbitrage on bond proceeds. Exceptions to the yield restriction requirement permit an issuer to earn arbitrage in limited circumstances, such as during limited temporary periods for prompt spending of bond proceeds and other similar temporary periods.

Under section 148(f) of the Code, the arbitrage rebate requirement provides that a bond is an arbitrage bond if the issuer fails to timely rebate to the United States arbitrage otherwise permitted to be earned on certain investments acquired with bond

proceeds. Generally, arbitrage rebate is paid every 5 years and upon the redemption of the bond issue.

The Existing Regulations provide detailed rules for applying the two types of arbitrage restrictions, including rules for determining yield on the bond issue and yield on the investments, and rules for computing and paying arbitrage rebate. The Treasury Department and the IRS believe that discrete changes need to be made to the Existing Regulations to simplify and clarify certain provisions, to make certain provisions more administrable, and to update the regulations to reflect current market practices.

II. ***Proposed Regulations***

The Proposed Regulations make a number of discrete changes to the Existing Regulations. Highlighted in this preamble are certain more substantive changes which are discussed in further detail. In addition, certain more minor changes are addressed in summary form.

(1) *Hedges based on taxable interest rates.* The Proposed Regulations make revisions to accommodate certain hedges in which floating payments under the hedge are based on a taxable interest rate and to clarify that bonds covered by such a hedge are ineligible for treatment as fixed yield bonds under the special hedging rule in §1.148–4(h)(4).

(2) *Joint Bond Yield Authority.* The Proposed Regulations remove the provision in the Existing Regulations that permits the IRS Commissioner to authorize a single yield computation on multiple bond issues.

(3) *Electronic GIC Bidding.* The Proposed Regulations revise the bidding safe harbor for establishing the fair market value of guaranteed investment contracts (GICs) to accommodate electronic bidding.

(4) *Refunds of Overpayments of Rebate.* The Proposed Regulations clarify that the amount that an issuer is entitled to receive under a rebate refund claim is the excess of the total amount actually paid over the rebate amount.

A. *Changes to Accommodate Certain Hedges*

Section 1.148–4 of the Existing Regulations sets forth rules for determining the yield on an issue of bonds for purposes of applying the arbitrage rules. In general, §1.148–4(h) of the Existing Regulations permits issuers to compute the yield on an issue by taking into account payments under "qualified hedges." The Existing Regulations provide two ways in which a qualified hedge can be taken into account in computing yield on the issue, known commonly as "simple integration" and "super integration."

For both simple integration and super integration, a hedge must be a "qualified hedge," which is a hedge that meets a series of eligibility requirements. Generally, in order to be a qualified hedge, a hedge must be interest based, the terms of the hedge must correspond closely with the terms of the hedged bonds, the issuer must duly identify the hedge, and the hedge must contain no significant investment element. For super integration, the hedge must meet additional eligibility requirements which focus on assuring that the terms of the hedge and the hedge bonds sufficiently correspond so as to warrant treating the hedged bonds as fixed-yield bonds for arbitrage purposes.

In the case of simple integration, generally all net payments on the hedge and the hedged bonds are taken into account in determining the yield on the bond issue. For example, if an issuer issues bonds paying interest at a variable rate and enters into a hedge under which the issuer receives floating interest rate payments from the hedge provider and pays fixed interest payments to the hedge provider (a variable-to-fixed hedge), the variable rate that the issuer pays to the bondholders, the floating rate that the issuer receives on the hedge, and the fixed payments that the issuer pays on the hedge are all taken into account on a net basis in determining the yield on the bond issue. In the case of simple integration, the hedged bonds are treated as variable yield bonds, which means that the yield on the bond issue is periodically recomputed and the rebate the issuer must pay to the United States is based on the issuer's actual net payments and receipts on the bond and the hedge. Thus, for example, any "basis risk" difference between the actual interest rate that the issuer pays on its variable-yield hedged bond and the actual interest rate it receives on the floating interest rate on the hedge (along with the fixed payments on the hedge) is taken into account in determining the yield on the hedged bonds.

In the case of super integration where the payments on the hedge and the hedged bonds sufficiently correspond so that the yield on the hedged bonds is fixed and determinable with certain assumptions, the hedged bonds are treated as fixed-yield bonds for arbitrage purposes. In the case of super integration, any basis risk difference between the floating-rate interest payments on the hedge and the variable-rate interest payments on the hedged bonds is ignored in determining the yield on the hedged bonds for arbitrage purposes through an assumption that treats those floating and variable rates as the same.

One of the eligibility requirements for a qualified hedge under the Existing Regulations is that it be interest based. For simple integration, one of the subsidiary aspects used in determining whether a variable-to-fixed interest rate hedge is interest based focuses on whether the variable interest rate on the hedged bonds and the floating interest rate on the hedge are "substantially the same." For super integration purposes, such rates must be "reasonably expected to be substantially the same throughout the term of the hedge." This aspect of the interest-based contract standard has raised technical issues in recent years in connection with its application to certain kinds of hedges, as discussed further in this preamble.

In general, hedging plays an increasingly important role in the tax-exempt bond market. An issuer of bonds may use hedges to protect itself against interest rate risks. For example, an issuer that issues variable-rate bonds may hedge or protect itself against unfavorable interest rate changes in the market by entering into a variable-to-fixed interest rate swap. Historically, issuers of tax-exempt bonds generally used a type of swap under which the hedge provider paid a floating interest rate that was determined based on a market index of tax-exempt interest rates, such as the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index.

A significant development in the tax-exempt bond market since the promulgation of the Existing Regulations has been the trend toward the use by issuers of variable-to-fixed interest rate swaps as hedges

in which the floating interest rate that the swap provider pays to the issuer is determined based on a percentage of a market index of taxable interest rates, such as the London Interbank Offered Rate (LIBOR) (a taxable-index hedge). Issuers have indicated that these taxable-index hedges offer more liquidity, more transparency in pricing, and lower costs than hedges based on a tax-exempt interest index.

Issuers have raised interpretative questions about how to apply the qualified hedge provisions of the Existing Regulations to taxable-index hedges because interest rates on taxable indices generally do not correspond as closely as interest rates on tax-exempt market indices to actual market interest rates on tax-exempt, variable-rate bonds. These interpretative questions are particularly important for taxable-index hedges used with advance refunding bond issues because issuers generally need to use the qualified hedge rules or some other regime to determine with certainty the yield on the tax-exempt advance refunding bonds in order to comply with the applicable arbitrage yield restrictions on investments in defeasance escrows.

The IRS and the Treasury Department have determined that taxable-index hedges based on widely-used taxable indices, such as LIBOR based hedges, sufficiently improve the efficiency of the tax-exempt bond market to warrant accommodation. The Proposed Regulations accommodate these hedges by modifying (1) the provisions for "yield reduction payments," which permit an issuer to reduce yield on an investment by making payments to the Federal government in certain permitted circumstances to comply with yield restriction rules and (2) the qualified hedge provisions. The Proposed Regulations make clear, however, that while taxable-index hedges can be qualified hedges, and therefore eligible for simple integration, they are not eligible for super integration because there is an insufficient correlation between tax-exempt bond interest rates and taxable market interest rate indices. However, the IRS and the Treasury Department understand that issuers have recently issued variable-rate bonds that bear interest equal to a percentage of LIBOR, and seek public comments on whether special accommodation under the super integration rule is required for those bond issues.

Yield reduction payments effectively integrate the yield restriction requirements with the arbitrage rebate requirements. For certain limited situations, §1.148–5(c) of the Existing Regulations permits yield reduction payments to be paid to the United States to satisfy yield restriction requirements on certain investments. Yield reduction payments are similar to, but not identical to, rebate payments. In general, the purpose of the yield reduction payment rules is to simplify compliance with the sometimes overlapping yield restriction and arbitrage rebate requirements by allowing issuers to make payments similar to rebate payments to the United States to satisfy yield restriction and rebate in appropriate circumstances. For example, an issuer may effectively reduce the yield on an investment to a yield that will not violate the yield restriction rules and also satisfy the arbitrage rebate requirement through a yield reduction payment.

The Proposed Regulations modify the yield reduction payment rules to permit issuers to make yield reduction payments on certain variable-yield advance refunding issues in which the issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap to hedge its interest rate risk. This modification to the yield reduction rule applies for nonpurpose investments allocable to gross proceeds of an advance refunding issue deposited into an advance refunding escrow when: (1) the issuer has entered into a qualified hedge in the form of a variable-to-fixed interest rate swap on all of its variable-rate bonds that are allocable to the yield restricted defeasance escrow, (2) the hedge covers a period from the issue date of the bonds until the final payment is made from the defeasance escrow, and (3) the yield on the advance refunding escrow is not reasonably expected to exceed the yield on the issue, determined by taking into account the fixed payments that the issuer is expected to make under the hedge and by assuming that the corresponding variable interest payments to be made by the issuer on the hedged bonds and to be received by the issuer on the hedge are equal and paid on the same date. In effect, the Proposed Regulations allow yield reduction payments in this context only to be made to cover the basis risk differences between the hedge and the hedged bonds.

The Proposed Regulations also modify the qualified hedge provisions to provide that the floating rate on the taxable-index hedge and the variable rate on the hedged bonds will be treated as substantially the same for purposes of §1.148–4(h)(2)(v)(B) if: (1) the difference between the two rates is not greater than one-quarter of one percent (.25 percent, or 25 basis points) on the date the issuer enters into the hedge, and (2) for a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and an interest rate determined in the same manner as the floating interest rate on the hedge does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined on the same days as the issuer's actual interest rates (or tax-exempt index, if applicable) are determined, is compared to the issuer's actual interest rates (or the tax-exempt index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

The Proposed Regulations also make certain other limited changes to the hedging and yield reduction rules which are discussed with other miscellaneous changes in this preamble.

B. *Joint Yield Authority*

In general, for arbitrage purposes, the yield on a bond issue is determined on an issue-by-issue basis. Section 1.148–4(a) of the Existing Regulations, however, authorizes the IRS Commissioner to permit issuers of certain types of tax-exempt bonds, specifically qualified mortgage bonds and qualified student loan bonds,

to compute a single joint bond yield for purposes of applying the arbitrage restrictions to two or more issues of these types of tax-exempt bonds.

Since the promulgation of the Existing Regulations, the IRS has received numerous private letter ruling requests for joint bond yield computations and has ruled on one of these requests. The Treasury Department and the IRS, based on what the IRS has learned from these ruling requests, are concerned about the highly factual nature of the requests, and the potential for arbitrage manipulations with joint yield computations that would not be apparent from a private letter ruling request and that could not reasonably be discovered in the context of such a request. For these reasons, the Proposed Regulations eliminate the regulatory provision that permits joint yield computations. However, the Treasury Department and the IRS are considering whether generally applicable, objective standards can be created under which joint yield computations should be allowed. Accordingly, the Proposed Regulations solicit public comments on when joint yield computations are needed for sound business reasons and whether objective standards can be created that would allow these computations in a manner that is consistent with the purposes of section 148. In addition, comments are sought on the following: the treatment of open-ended joint yield calculations that allow future issues to be included in the joint yield computation, the treatment of qualified hedges or guarantees that cover some but not all of the bonds, the treatment of reserves, the application of prepayment assumptions, the effect of partial refundings, and other issues that impact the administrability of joint yield calculations. Pending final resolution of this issue, the IRS will not entertain any private letter ruling requests for permission to use a joint yield computation.

C. *Modified Fair Market Value Safe Harbor for Guaranteed Investment Contracts*

Under §1.148–5(d)(3) of the Existing Regulations, investments purchased with bond proceeds must be valued at fair market value. Section 1.148–5(d)(6)(iii) of the Existing Regulations provides a safe harbor for establishing the fair market value of a guaranteed investment contract (GIC) for arbitrage purposes. That safe harbor generally relies on a prescribed bidding procedure and the receipt of at least three bids from independent parties. The bidding process requirements under the safe harbor include a requirement that all bidders be given an equal opportunity to bid with no opportunity to review other bids (that is, the "no last look" rule) and a requirement that the bid specifications be provided to prospective bidders "in writing."

In the past several years, the tax-exempt bond market has seen the advent of various electronic bidding procedures and internet platforms for bidding GICs. While the particular features of specific GIC bidding procedures may vary, characteristics of these electronic GIC bidding procedures generally include using the internet to receive bid specifications and to make bids. The electronic bidding process permits providers, under prescribed times and procedures, to continuously bid and to continuously view the current highest bids (without identification of the bidders). The electronic platforms also provide the capability to print out the results of the GIC bidding process. The electronic GIC bidding procedures have raised certain technical issues regarding whether they can comply with the fair market value safe harbor for GICs under the Existing Regulations.

The Treasury Department and the IRS believe that electronic GIC bidding procedures generally offer the constructive potential for increasing the transparency of pricing of investments purchased with proceeds of tax-exempt bonds. Accordingly, the Proposed Regulations amend the fair market value safe harbor for GICs to accommodate electronic bidding procedures by 1) permitting bid specifications to be sent electronically over the internet or by fax and 2) amending the no last look rule to provide that there is not a prohibited last look if all bidders have an equal opportunity for a last look.

D. *Recovery of Overpayment of Rebate*

Generally, an issuer computes the amount of arbitrage rebate that it owes under a method that future values payments and receipts on investments using the yield on the bond issue. Under this method, an arbitrage payment made on one computation date is future valued to the next computation date to determine the amount of arbitrage rebate owed on that subsequent computation date. Section 1.148–3(i)(1) of the Existing Regulations provides that an issuer may recover an overpayment of arbitrage rebate with respect to an issue of tax-exempt bonds if the issuer establishes to the satisfaction of the IRS Commissioner that an overpayment occurred. Section 1.148–3(i)(1) further defines an overpayment as the excess of "*the amount paid*" (emphasis added) to the United States for an issue under section 148 over the sum of the rebate amount for that issue as of the most recent computation date and all amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Thus, even if the future value of the issuer's arbitrage rebate payment on a computation date, computed under the method for determining arbitrage rebate, is greater than the issuer's rebate amount on that date, an issuer is only entitled to a refund to the extent that the amount actually paid exceeds that rebate amount. The Existing Regulations limit the amount of the refund in this manner because the Treasury Department and the IRS were concerned about whether the IRS had statutory authority to pay interest on arbitrage rebate payments. To permit a refund in an amount calculated in whole or in part based upon a future value of the amount actually paid would effectively result in an interest payment on that payment.

Example 2(iii)(D) in §1.148–3(j) of the Existing Regulations has caused confusion because it could be interpreted to mean that an issuer can receive a refund of a rebate payment when the future value of such rebate payment exceeds the rebate amount on the next computation date, even though the actual amount of the previous rebate payment does not exceed the rebate amount on that next computation date. The Proposed Regulations make a technical amendment to this example to conform this example to the intended purpose of §1.148–3(i)(1). Because the proposed change does not change the regulatory rule, but merely makes an existing example conform to that rule, the Proposed Regulations provide that the effective date for this provision is the same as the effective date for the regulatory rule. However, the IRS will not reopen rebate re-

fund claims that have been processed before the date the Proposed Regulations are published in the **Federal Register**.

E. *Other Miscellaneous Changes*

1. *Qualified Hedge Provisions.*

The Proposed Regulations make the following additional changes to the hedging rules in §1.148–4(h) and specifically seek the following comments on the hedging rules.

a. *Cost of Funds Hedges.* The Proposed Regulations clarify that for purposes of applying the definition of periodic payment under §1.446–3(e)(1) to determine whether a hedge has a significant investment element under §1.148–4(h)(2)(ii)(A), a "specified index" under §1.446–3(c)(2) (upon which periodic payments are based) is deemed to include payments under a cost-of-funds swap, thereby eliminating any doubt that these hedges can be qualified hedges.

b. *Size and Scope of a Qualified Hedge.* The Proposed Regulations add an express requirement under §1.148–4(h)(2)(v) that limits the size and scope of a qualified hedge to a level that is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. This proposed limitation is comparable to a former provision that was in the arbitrage regulations from 1993 to 1997, but was removed in connection with 1997 amendments to the Existing Regulations. The Treasury Department and the IRS believe that this principle was implicitly carried forward in the subsidiary standards under the interest-based contract requirement in the Existing Regulations in 1997. The Proposed Regulations, however, provide an explicit separate requirement to clarify the continued application of this principle.

c. *Correspondence of Payments for Simple Integration.* Commentators have requested guidance on what time period satisfies the rule under §1.148–4(h)(2)(vi) that requires payments on a hedge to correspond closely in time to the payments on the hedged bonds. The Proposed Regulations add a rule for simple integration that treats payments as corresponding closely in time for this purpose if the payments are made within 60 calendar days of each other. This proposed rule contrasts with the rules for super integration, which require that payments be made within 15 days of each other. The Proposed Regulations provide a more flexible time period for correspondence of payments for simple integration purposes consistent with the fact that simple integration results in more accurate accounting for all net payments.

d. *Time for Identification of Qualified Hedges.* Commentators have indicated that the three-day period for identifying a hedge under §1.148–4(h)(2)(viii) of the Existing Regulations raises practical difficulties, particularly with respect to hedges that are not entered into contemporaneously with the issuance of the hedged bonds. The Proposed Regulations extend the time in §1.148–4(h)(2)(viii) for when an issuer must identify a qualified hedge from three days to fifteen days and clarify that these are calendar days. The Proposed Regulations, however, retain the requirement that the actual State or local governmental issuer, rather than the conduit borrower, identify the hedge because the Treasury Department and the IRS believe that it is important for State and local governments to be responsible for qualified hedges on their bonds.

e. *Termination of Hedges at Fair Market Value.* The Proposed Regulations clarify that under §1.148–4(h)(3)(iv)(B), the termination payment for a termination or a deemed termination is equal to the fair market value of the hedge on the termination date.

f. *Solicitation of Comment on Offsetting Hedges.* The Treasury Department and the IRS have received requests for clarification of the scope of the rule that treats offsetting hedges as deemed terminations of qualified hedges under §1.148–4(h)(3)(iv)(A). The Treasury Department and the IRS seek express public comment regarding the types of offsetting hedges that are necessary for valid business purposes and recommendations on how to clarify the scope of this rule on offsetting hedges.

2. *Yield Reduction Payment Rules.*

The Proposed Regulations permit issuers to make yield reduction payments for nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the Department of Treasury, Bureau of Public Debt, has suspended sales of SLGS. This provision incorporates and expands Revenue Procedure 95–47, 1995–2 C.B. 417, which permits yield reduction payments in more limited situations than the Proposed Regulations when SLGS are unavailable.

The Proposed Regulations also reorganize the yield reduction rules to make them easier to read.

3. *Modification of Yield Computation for Yield-to-Call Premium Bonds.*

The Proposed Regulations simplify the rules for computing yield on an issue that has certain callable premium bonds. Existing Regulations generally provide that the yield on an issue is based on the yield to maturity, taking into account certain assumptions. The Existing Regulations have a special rule for certain callable bonds issued with significant amounts of bond premium (sometimes called yield-to-call bonds), which requires a determination of yield to a call date, based on certain assumed optional redemptions. The general purpose of this rule is to recognize that a yield-to-maturity computation may not be economically accurate in this circumstance because these yield-to-call bonds are more likely than other bonds to be called before maturity and before amortization of the premium.

Section 1.148–4(b)(3)(i) of the Existing Regulations treats a yield-to-call bond as redeemed at the stated redemption price on the optional redemption date that would produce the lowest yield on the *issue* (as contrasted with the lowest yield on the particular premium bond). This methodology, which considers the lowest yield on the issue for these yield-to-call bonds, requires computations of possible combinations of redemption dates in circumstances in which the variations of redemption dates may have very limited impact on yield.

The Proposed Regulations simplify the yield calculations for these yield-to-call bonds to focus on the redemption date that results in the lowest yield on the particular premium bond (rather than the more complex existing focus on the lowest yield on the issue). This change corresponds to a former version of this regulatory rule which was in effect under applicable arbitrage regulations from 1989 through 1992.

4. *Arbitrage Rebate Computation Credit.*

Section 1.148–3(d)(1)(iv) of the Existing Regulations provides that an issuer

may take certain credits against payment of arbitrage rebate in the amount of $1,000 for each rebate computation date, subject to certain limitations, to help offset the cost of computing rebate. The Proposed Regulations increase this rebate credit to $1,400 for any bond year ending in the year 2007 to reflect the change in the Consumer Price Index since the $1,000 rebate credit was published. The Proposed Regulations further adjust the computation date credit for inflation for bond years ending in each year thereafter.

5. *External Commingled Investment Funds.*

The Existing Regulations provide certain preferential rules for the treatment of administrative costs to certain widely-held "external commingled funds," as defined in §1.148–5(e)(2)(ii)(B). Under the Existing Regulations, a fund is treated as widely held if the fund, on average, has more than 15 unrelated investors each of which maintains prescribed minimum average investments in the fund. The Proposed Regulations make a technical change to allow additional smaller investors to invest in an external commingled fund without disqualifying the fund so long as at least 16 unrelated investors each maintain the required minimum average investments in the fund.

6. *Pooled Bonds.*

The Proposed Regulations make conforming changes to §1.148–8(d) to reflect legislative changes made to section 148(f)(4)(D) by section 508 of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109–222, 120 Stat. 345 (TIPRA). Under TIPRA, Congress eliminated the rule in §148(f)(4)(D)(ii)(II) that permitted a pool bond issuer to ignore its pool bond issue in computing whether it had exceeded its $5 million limit for purposes of the small issuer rebate exception of section 148(f)(4)(D). Correspondingly, the Proposed Regulations eliminate the provisions in the Existing Regulations that permit a pool bond issuer to ignore the amount of its pool bond issue in determining whether the issuer meets the small issuer exception of section 148(f)(4)(D). The Proposed Regulations retain the provision that permits a State or local governmental conduit borrower to ignore the amount of certain pool bond issues in excess of the amount it borrows from that pool. Consistent with the statutory change, the Proposed Regulations provide that the change for pool bond issuers is effective for bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

III. *Effective Dates*

The Proposed Regulations are proposed to apply to bonds sold on or after a date that is 90 days after publication of final regulations in the **Federal Register**, but an issuer may apply certain specified provisions of the Proposed Regulations to bonds sold before the date that is 90 days after publication of the final regulations in the Federal Register as provided in proposed §1.148–11(k). Except for the changes to the qualified hedging rules which must be applied in their entirety, issuers that are permitted, but not required, to apply the proposed changes may apply some or all of the changes to a bond issue.

The Proposed Regulations contain a technical amendment to the example in the general arbitrage rebate rules. This change applies to bonds subject to §1.148–3(i), the dates of applicability for which are set forth in the Existing Regulations.

The Proposed Regulations contain a special effective date provision for the regulatory change that conforms the arbitrage regulations to the legislative change made to the small issuer rebate exception for pooled bond issuers. This change applies to bonds issued after May 17, 2006, the effective date of the relevant provision of TIPRA.

Effect On Other Documents

On the date of applicability of the final regulations, Revenue Procedure 95–47, 1995–2 C.B. 417, will be obsoleted.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Some of the proposed changes clarify existing regulatory provisions, conform the regulations to a recent statutory change, or otherwise involve simplifying or clarifying changes that will not have a significant economic impact on governmental jurisdictions or other entities of any size. Other proposed changes involve the treatment of certain hedging transactions, such as interest rate swaps, for purposes of the arbitrage investment restrictions on tax-exempt bonds issued by State and local governments. Although there is a lack of available data regarding the extent of usage of these hedging transactions by small entities, the IRS and the Treasury Department understand that these hedging transactions are used primarily by larger State and local governments and other eligible larger entities. The IRS and the Treasury Department specifically solicit comment from any party, particularly affected small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Small Business Administration for comment on its impact on small governmental jurisdictions.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 30, 2008 at 10 a.m. in the Main IRS Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 2, 2008. A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Rebecca L. Harrigal and Carla A. Young, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.148–0, 1.148–3, 1.148–4, 1.148–5, 1.148–8 and 1.148–11 also issued under 26 U.S.C. 148(i).

Par. 2. Section 1.148–0(c) is amended as follows:

1. Add entry for new paragraph (d)(4) in the table of contents for §1.148–3.

2. Revise entry for paragraph (d) in the table of contents for §1.148–8.

3. Remove entries for paragraph (d)(1) and paragraph (d)(2) in the table of contents for §1.148–8.

4. Add entries for new paragraphs (k), (k)(1), (k)(2), (k)(3) and (k)(4) in the table of contents for §1.148–11.

The revised and added provisions read as follows:

§1.148–0 Scope and Table of Contents.

* * * * *

§1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(4) Cost-of living adjustment.

* * * * *

§1.148–8 Small issuer exception to rebate requirement.

* * * * *

(d) Pooled financings — treatment of conduit borrowers.

* * * * *

§1.148–11 Effective dates.

* * * * *

(k) Certain arbitrage guidance updates.

(1) In general.

(2) Permissive earlier application.

(3) Rebate overpayment recovery.

(4) Small issuer exception to rebate requirement for conduit borrowers of pooled financings.

* * * * *

Par. 3. Section 1.148–3 is amended by revising paragraph (d)(1)(iv) and adding a new paragraph (d)(4) as follows:

§1.148–3 General arbitrage rebate rules.

* * * * *

(d) * * *

(1) * * *

(iv) On the last day of each bond year during which there are amounts allocated to gross proceeds of an issue that are subject to the rebate requirement, and on the final maturity date, a computation credit of $1,400 for any bond year ending in 2007 and, for bond years ending after 2007, a computation credit in the amount determined under paragraph (d)(4) of this section; and

* * * * *

(4) *Cost-of-living adjustment.* For any calendar year after 2007, the $1,400 computation credit set forth in paragraph (d)(1)(iv) shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such year as modified by this paragraph (d)(4). In applying section 1(f)(3) to determine this cost-of-living adjustment, the reference to "calendar year 1992" in section 1(f)(3)(B) shall be changed to "calendar year 2006." If any such increase determined under this paragraph (d)(4) is not a multiple of $10, such increase shall be rounded to the nearest multiple thereof.

* * * * *

Par. 4. Section 1.148–3(j) is amended by revising *Example 2*(iii)(D) to read as follows:

§1.148–3 General arbitrage rebate rules.

* * * * *

(j) * * *

Example 2. * * *

(iii) * * *

(D) If the yield during the second computation period were, instead, 7.0000 percent, the rebate amount computed as of July 1, 2004, would be $1,320,891. The future value of the payment made on July 1, 1999, would be $1,471,007. Although the future value of the payment made on July 1, 1999 ($1,471,007), exceeds the rebate amount computed as of July 1, 2004 ($1,320,891), §1.148–3(i) limits the amount recoverable as a defined overpayment of rebate under section 148 to the excess of the total "amount paid" over the sum of the amount determined under the future value method to be the "rebate amount" as of the most recent computation date and all other amounts that are otherwise required to be paid under section 148 as of the date the recovery is requested. Because the total amount that the issuer paid on July 1, 1999 ($1,042,824.60), does not exceed the rebate amount as of July 1, 2004 ($1,320,891), the issuer would not be entitled to recover any overpayment of rebate in this case.

* * * * *

Par. 5. Section 1.148–4(a) is revised to read as follows:

§1.148–4 Yield on an issue of bonds.

(a) *In general.* The yield on an issue of bonds is used to apply investment yield restrictions under section 148(a) and to compute rebate liability under section 148(f). Yield is computed under the economic accrual method using any consistently applied compounding interval of not more than one year. A short first compounding interval and a short last compounding interval may be used. Yield is expressed

as an annual percentage rate that is calculated to at least four decimal places (for example, 5.2525 percent). Other reasonable, standard financial conventions, such as the 30 days per month/360 days per year convention, may be used in computing yield but must be consistently applied. The yield on an issue that would be a purpose investment (absent section 148(b)(3)(A)) is equal to the yield on the conduit financing issue that financed that purpose investment.

* * * * *

Par. 6. Section 1.148–4 is amended by:

1. Revising paragraph (b)(3)(i), and adding a new sentence at the end of paragraph (h)(2)(ii)(A).
2. Revising the heading and introductory text of paragraph (h)(2)(v).
3. Amending paragraph (h)(2)(v)(B) by revising the last sentence.
4. Adding paragraphs (h)(2)(v)(B)(*1*), (*2*) and (*3*).
5. Adding a new sentence at the end of paragraph (h)(2)(vi).
6. Revising the heading and first sentence of paragraph (h)(2)(viii).
7. Amending paragraph (h)(3)(iv)(B) by adding a new sentence immediately after the first sentence.
8. Adding a new sentence at the end of paragraph (h)(4)(i)(C).

The revised and added provisions read as follows:

§1.148–4 Yield on an issue of bonds.

* * * * *

(b) * * *

(3) *Yield on certain fixed yield bonds subject to optional early redemption*—(i) *In general.* If a fixed yield bond is subject to optional early redemption and is described in paragraph (b)(3)(ii) of this section, the yield on the issue containing the bond is computed by treating the bond as redeemed at its stated redemption price on the optional redemption date that would produce the lowest yield on that bond.

* * * * *

(h) * * *

(2) * * *

(ii) * * * (A) * * * For purposes of applying the definition of periodic payment under §1.446–3 to determine whether a hedge has a significant investment element under this paragraph (h)(2)(ii)(A), the definition of "specified index" under §1.446–3 (upon which periodic payments are required to be based) is deemed also to include payments an issuer receives under a hedge that are computed to be equal to the issuer's cost of funds, such as the issuer's actual market-based tax-exempt variable interest rate on its bonds.

* * * * *

(v) *Interest-based contract and size and scope of hedge.* The contract is primarily interest-based (for example, a hedge based on a debt index rather than an equity index). In addition, the size and scope of the hedge under the contract is limited to that which is reasonably necessary to hedge the issuer's risk with respect to interest rate changes on the hedged bonds. For example, a contract is limited to hedging an issuer's risk with respect to interest rate changes on the hedged bonds if the hedge is based on the issuer's principal amount of bonds and reasonably expected interest requirements rather than based on a greater notional amount or an interest rate level greater than the expected interest requirements. A contract is not primarily interest based unless —

* * * * *

(B) * * * For this purpose, differences that would not prevent the resulting bond from being substantially similar to another type of bond or to result in overhedging include:

(*1*) A difference between the interest rate used to compute payments on the hedged bond and the interest rate used to compute payments on the hedge where one interest rate is substantially the same as, but not identical to, the other. For this purpose, if an interest rate swap under which the issuer pays the hedge provider a fixed interest payment and receives from the hedge provider a floating interest rate that is based on a taxable interest rate or a taxable market interest rate index, the floating rate on the hedge and the variable rate on the hedged bonds will be treated as being substantially the same only if:

(*i*) The difference between the interest rate on the issuer's hedged bonds and the floating interest rate on the hedge does not exceed one quarter of one percent (.25 percent, or 25 basis points) on the date that the issuer enters into the hedge; and

(*ii*) For a three-year period that ends on the date the issuer enters into the hedge, the average difference between the issuer's actual tax-exempt interest rate on comparable variable-rate bonds (or, if no such comparable bonds exist, rates from a reasonable tax-exempt interest rate index, such as the SIFMA Municipal Swap Index, for that same period) and interest rates determined in the same manner as the floating interest rate on the hedge and as of the same dates as the issuer's comparable variable-rate bonds (or the tax-exempt market index, if applicable) does not exceed one-quarter of one percent (.25 percent, or 25 basis points). For example, if the floating rate on the hedge is 67 percent of LIBOR, then 67 percent of LIBOR, determined as of the same dates as the issuer's actual interest rates (or tax-exempt market index, if applicable) is compared to those actual interest rates (or the tax-exempt market index, if applicable) for the three-year period ending on the date the hedge is entered into and the differences are averaged to determine whether the average difference exceeds one-quarter of one percent. For this purpose, a reasonable sample may be used if the sample for the issuer's actual rates (or tax-exempt market index rates, if applicable) and the sample of floating rates used for the hedge are determined as of the same dates.

(*2*) A difference resulting from the payment of a fixed premium for a cap (for example, payments for a cap that are made in other than level installments).

(*3*) A difference resulting from the allocation of a termination payment if the termination was unexpected as of the date that the parties entered into the hedge contract.

(vi) * * * For this purpose, such payments will be treated as corresponding closely in time under this paragraph (h)(2)(vi) if they are made within 60 calendar days of each other.

* * * * *

(viii) *Reasonably contemporaneous identification.* The contract must be identified by the actual issuer on its books and records maintained for the hedged bonds not later than 15 calendar days after the date on which the issuer and the hedge provider enter into the hedge contract. * * *

(3) * * *

(iv) * * *

(B) * * * The amount of the termination payment in a termination or deemed termination is equal to the fair market value of the qualified hedge on the date of the termination.* * *

* * * * *

(4) * * *

(i) * * *

(C) * * * Except for an anticipatory hedge that is terminated or otherwise closed substantially contemporaneously with the hedged bond in accordance with paragraph (h)(5)(ii) or (h)(5)(iii) of this section, a hedge based on a taxable interest rate or taxable interest index (for example, the London Interbank Offered Rate or LIBOR) does not meet the requirements of this paragraph (C).

* * * * *

Par. 7. Section 1.148–5(c) is amended by:

1. Removing existing paragraph (c)(3)(ii).

2. Adding introductory language to paragraph (c)(3).

3. Removing the heading in paragraph (c)(3)(i) and redesignating the existing text in paragraph (c)(3)(i)(A) as the text in paragraph (c)(3)(i).

4. Redesignate existing paragraphs (c)(3)(i)(B), (c)(3)(i)(C), (c)(3)(i)(D), (c)(3)(i)(E), (c)(3)(i)(F), and (c)(3)(i)(G) as paragraphs (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi), and (c)(3)(vii), respectively.

5. Redesignate existing paragraphs (c)(3)(i)(C)(*1*) and (c)(3)(i)(C)(*2*) as paragraphs (c)(3)(iii)(A) and (c)(3)(iii)(B), respectively, in newly redesignated paragraph (c)(3)(iii).

6. Redesignate existing paragraphs (c)(3)(i)(E)(*1*) and (c)(3)(i)(E)(*2*) as paragraphs (c)(3)(v)(A) and (c)(3)(v)(B), respectively, in newly redesignated paragraph (c)(3)(v).

7. Amend newly redesignated paragraph (c)(3)(i), (c)(3)(ii), (c)(3)(iii), (c)(3)(iv), (c)(3)(v), (c)(3)(vi) and (c)(3)(vii) by adding headings to each paragraph.

8. Revise newly redesignated paragraph (c)(3)(v).

9. Revise newly redesignated paragraph (c)(3)(vi).

10. Amend newly redesignated paragraph (c)(3)(vii) by removing the period at the end of the paragraph and replacing it with a semicolon.

11. Amending paragraph (c)(3) by adding new paragraphs (c)(3)(viii) and (c)(3)(ix).

The revised and added provisions read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(c) * * *

(3) *Applicability of special yield reduction rule.* Except as otherwise expressly provided in paragraphs (c)(3)(i) through (ix) of this section, paragraph (c) applies only to investments listed in paragraphs (c)(3)(i) through (c)(3)(ix) of this section that are allocated to proceeds of an issue other than gross proceeds of an advance refunding issue.

(i) *Nonpurpose investments allocated to proceeds of an issue that qualified for certain temporary periods.* * * *

(ii) *Investments allocable to certain variable yield issues.* * * *

(iii) *Nonpurpose investments allocable to certain transferred proceeds.* * * *

(A) * * *

(B) * * *

(iv) *Purpose investments allocable to certain qualified student loans.* * * *

(v) *Nonpurpose investments allocable to gross proceeds in certain reserve funds.* Nonpurpose investments allocable to gross proceeds of an issue in a reasonably required reserve or replacement fund or a fund that, except for its failure to satisfy the size limitation in §1.148–2(f)(2)(ii), would qualify as a reasonably required reserve or replacement fund, but only to the extent the requirements in paragraphs (c)(3)(v)(A) or (B) of this section are met. This paragraph (c)(3)(v) includes nonpurpose investments described in this paragraph that are allocable to transferred proceeds of an advance refunding issue, but only to the extent necessary to satisfy yield restriction under section 148(a) on those proceeds treating all investments allocable to those proceeds as a separate class.

(A) * * *

(B) * * *

(vi) *Nonpurpose investments allocable to certain replacement proceeds of refunded issues.* Nonpurpose investments allocated to replacement proceeds of a refunded issue, including a refunded issue that is an advance refunding issue, as a result of the application of the universal cap to amounts in a refunding escrow;

(vii) *Investments allocable to replacement proceeds under a certain transition rule.* * * *

(viii) *Nonpurpose investments allocable to proceeds when SLGS are unavailable.* Nonpurpose investments allocable to proceeds of an issue, including an advance refunding issue, that an issuer purchases on a date when the issuer is unable to purchase State and Local Government Series Securities (SLGS) because the U.S. Department of Treasury, Bureau of Public Debt, has suspended sales of those securities; and

(ix) *Nonpurpose investments allocable to proceeds of certain variable-yield advance refunding issues.* Nonpurpose investments allocable to proceeds of a variable-yield advance refunding issue (the hedged bond issue) deposited in a yield restricted defeasance escrow if—

(A) The issuer has entered into a qualified hedge under §1.148–4(h)(2) with respect to all of the variable-yield bonds of the issue allocable to the yield restricted defeasance escrow and that hedge is in the form of a variable-to-fixed interest rate swap under which the issuer pays the hedge provider a fixed interest rate and receives from the hedge provider a floating interest rate;

(B) Such qualified hedge covers a period beginning on the issue date of the hedged bond issue and ending on or after the date on which the final payment is to be made from the yield restricted defeasance escrow; and

(C) The issuer restricts the yield on the yield restricted defeasance escrow to a yield that is not greater than the yield on the hedged bond issue, determined by taking into account the issuer's fixed payments to be made under the hedge and by assuming that the issuer's variable yield payments to be paid on the hedged bonds are equal to the floating payments to be received by the issuer under the qualified hedge and are paid on the same dates (that is, such yield reduction payments can only be made to address basis risk differences between the variable yield payments on the hedged bonds and the floating payments received on the hedge).

* * * * *

Par. 8. Section 1.148–5(d)(6) is amended by revising paragraphs (d)(6)(iii)(A)(*1*) and (d)(6)(iii)(A)(*6*) to read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iii) * * *

(A) * * *

(*1*) The bid specifications are in writing and are timely forwarded, or are made available on an internet website or other similar electronic media that is regularly used to post bid specifications, to potential bidders. For purposes of this paragraph (d)(6)(iii)(A), a writing includes a hard copy, a fax, or an electronic email copy.

* * * * *

(*6*) All potential providers have an equal opportunity to bid. If the bidding process affords any opportunity for a potential provider to review other bids before providing a bid, then providers have an equal opportunity to bid only if all potential providers have an equal opportunity to review other bids. Thus, no potential provider may be given an opportunity to review other bids that is not equally given to all potential providers (that is, no exclusive "last look").

* * * * *

Par. 9. Section 1.148–5(e)(2) is amended by revising the second sentence of paragraph (e)(2)(ii)(B) to read as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(e) * * *

(2) * * *

(ii) * * *

(B) *External commingled funds.* * * * For purposes of this paragraph (e)(2)(ii)(B), a fund is treated as widely held only if, during the immediately preceding fixed, semiannual period chosen by the fund (for example, semiannual periods ending June 30 and December 31), the fund had a daily average of more than 15 investors that were not related parties, and at least 16 of the unrelated investors each maintained a daily average amount invested in the fund that was not less than the lesser of $500,000 and one percent (1%) of the daily average of the total amount invested in the fund (with it being understood that additional smaller investors will not disqualify the fund). * * *

* * * * *

Par. 10. Section 1.148–8(d) is revised to read as follows:

§1.148–8 Small Issuer Exception to Rebate Requirement.

* * * * *

(d) *Pooled financings — treatment of conduit borrowers.* A loan to a conduit borrower in a pooled financing qualifies for the small issuer exception, regardless of the size of either the pooled financing or of any loan to other conduit borrowers, only if—

(1) The bonds of the pooled financing are not private activity bonds;

(2) None of the loans to conduit borrowers are private activity bonds; and

(3) The loan to the conduit borrower meets all the requirements of the small issue exception.

* * * * *

Par. 11. Section 1.148–11 is revised by adding new paragraph (k) as follows:

§1.148–11 Effective Dates.

* * * * *

(k) *Certain arbitrage guidance updates.*

(1) *In general.* Sections 1.148–3(d)(1)(iv); 1.148–3(d)(4); 1.148–4(a); 1.148–4(b)(3)(i); 1.148–4(h)(2)(ii)(A); 1.148–4(h)(2)(v); 1.148–4(h)(2)(vi); 1.148–4(h)(2)(viii); 1.148–4(h)(3)(iv)(B); 1.148–4(h)(4)(i)(C); 1.148–5(c)(3); 1.148–5(d)(6)(iii)(A) and 1.148–5(e)(2)(ii)(B), as in effect on the effective date of the final regulations (the revised provisions), apply to bonds sold on or after the date that is 90 days after publication of the final regulations in the **Federal Register**, for bonds subject to such applicable section of the regulations as in effect before the effective date of the final regulations.

(2) *Permissive earlier application.* To the extent provided in paragraphs (k)(2)(i) through (vi) of this section, issuers may apply the proposed regulations to bonds sold before the date that is 90 days after publication of the final regulations in the **Federal Register**.

(i) Section 1.148–3(d)(1)(iv) and §1.148–3(d)(4) may be applied for bond years ending on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which 1.148–3(d)(1)(iv) applies.

(ii) Section 1.148–4(b)(3)(i) may be applied for bonds sold on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(iii) Sections 1.148–4(h)(2)(ii)(A), 1.148–4(h)(2)(v), 1.148–4(h)(2)(vi), 1.148–4(h)(2)(viii), 1.148–4(h)(3)(iv)(B), and 1.148–4(h)(4)(i)(C) may be applied, in whole but not in part, for qualified hedges entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which §1.148–4(h) applies.

(iv) Section 1.148–5(c)(3) may be applied for investments purchased on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(v) Section 1.148–5(d)(6)(iii)(A) may be applied to guaranteed investment contracts entered into on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which §1.148–5(d)(6)(iii) applies.

(vi) Section 1.148–5(e)(2)(ii)(B) may be applied with respect to investors investing in the fund on or after the date of publication of the proposed regulations in the **Federal Register** for bonds to which that section applies.

(3) *Rebate overpayment recovery.* Section 1.148–3(j) applies to bonds subject to §1.148–3(i).

(4) *Small issuer exception to rebate requirement for conduit borrowers of pooled financings.* Section 1.148–8(d) applies to bonds issued after May 17, 2006.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54606)

Notice of Proposed Rulemaking

Patented Transactions

REG–129916–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide rules relating to the disclosure of reportable transactions under sections 6011 and 6111 of the Internal Revenue Code (Code). These regulations propose to add the patented transactions category of reportable transaction to the regulations under §1.6011–4 of the Income Tax Regulations. The regulations also include conforming changes to the rules relating to the disclosure of reportable transactions by material advisors under section 6111. The regulations affect taxpayers participating in reportable transactions under section 6011, material advisors responsible for disclosing reportable transactions under section 6111, and material advisors responsible for keeping lists under section 6112.

DATES: Written or electronic comments and requests for a public hearing must be received by December 26, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–129916–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–129916–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–129916–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michael H. Beker or Charles D. Wien, (202) 622–3070; concerning the submissions of comments and requests for hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document proposes to amend 26 CFR parts 1 and 301 by adding the patented transactions category of reportable transaction to the rules under section 6011 and by making conforming changes to the rules relating to the disclosure of reportable transactions by material advisors under section 6111.

On November 1, 2006, the IRS and Treasury Department issued a notice of proposed rulemaking and temporary and final regulations under sections 6011, 6111, and 6112 (REG–103038–05, 2006–49 I.R.B. 1049, REG–103039–05, 2006–49 I.R.B. 1057, REG–103043–05, 2006–49 I.R.B. 1063, T.D. 9295, 2006–49 I.R.B. 1030) (the November 2006 regulations). The November 2006 regulations were published in the **Federal Register** (71 FR 64488, 71 FR 64496, 71 FR 64501, 71 FR 64458) on November 2, 2006. In the preamble to those proposed regulations, the IRS and Treasury Department expressed concern, shared by many commentators, regarding the patenting of tax advice or tax strategies that have the potential for tax avoidance. A patent for tax advice or a tax strategy might be interpreted by taxpayers as approval by the IRS and Treasury Department of the transaction, which might impede the efforts of the IRS and Treasury Department to obtain information regarding tax avoidance transactions and have an impact on effective tax administration. Consequently, the IRS and Treasury Department requested comments regarding the creation of a new category of reportable transaction to address these concerns.

The IRS and Treasury Department received written public comments responding to the proposed regulations and held a public hearing regarding the proposed rules on March 20, 2007. After consideration of the comments received, the IRS and Treasury Department are issuing these proposed regulations with respect to patented transactions. Upon publication of final regulations, these regulations will be effective for transactions entered into on or after the date of publication of this notice of proposed rulemaking.

Explanation of Provisions

In response to the request for comments, the IRS and Treasury Department received five comments regarding the creation of a new category of reportable transaction to address the patenting of tax advice or tax strategies. One commentator suggested that the patenting of tax advice or tax strategies should not be addressed through the addition of a new category of reportable transaction. The commentator suggested that the IRS should require a form of notification or have a disclosure requirement informing the IRS when the United States Patent and Trademark Office (USPTO) issues a tax strategy patent. The commentator suggested that this could be accomplished through cooperation between the IRS and the USPTO. To the extent cooperation does not result in the necessary disclosures, the commentator suggested that the current reportable transaction regime or another mechanism could provide the necessary notifications and disclosures.

One commentator suggested that the patenting of tax advice or tax strategies should be addressed through the transaction of interest category of reportable transaction under §1.6011–4(b)(6). The commentator suggested that each application for, or grant of a patent be automatically included within the scope of a transaction of interest, thereby requiring anyone who "participated" in the transaction to file a disclosure statement. In addition, the commentator suggested that the party who files an application for a patent, or for whom a patent is granted, be considered a material advisor, as defined in §301.6111–3(b) of the Procedure and Administration Regulations. The commentator noted that treating the patent applicant or holder as a material advisor would obligate that party to file a disclosure statement under §301.6111–3 and also to maintain an investor list under §301.6112–1. Further, the commentator proposed that each material advisor should be required to disclose to each taxpayer on that material advisor's list of investors that the transaction is a transaction of interest and that the taxpayer is required to disclose the transaction.

Two commentators suggested the creation of a new category of reportable transaction for taxpayers who participate

in a transaction that uses a patented tax strategy for each year in which the taxpayer's return reports items attributable to such transaction. The two commentators both suggested treating the patent holder as a material advisor within the meaning of section 6111. One of the two commentators suggested lowering the gross income threshold amounts for material advisors in §301.6111–3(b)(3). One of the commentators recommended that a material advisor should only include the owner of the patent and advisors who pay fees directly or indirectly for the patented tax strategy or advice. This commentator also recommended that the disclosure obligations be narrowly construed so as not to apply to those taxpayers and material advisors who implement patented tax strategies and provided advice without any knowledge that the tax strategy or advice has been patented.

Another commentator also recommended limiting the scope of a category of reportable transaction for patents so that the category applies only to those taxpayers and material advisors who have a legal right to use the patented tax strategy or tax advice. Finally, commentators recommended excluding from the category of reportable transaction the use of patented tax methods or processes for complying with return preparation and filing and other administrative requirements.

After careful consideration of the comments received, the IRS and Treasury Department continue to be concerned about the patenting of tax advice or tax strategies and believe that adding a new category of reportable transaction to the section 6011 regulations for patented transactions will assist the IRS and Treasury Department in obtaining disclosures of tax avoidance transactions and in providing effective tax administration. Under the new category of reportable transactions, the "patented transaction" is a transaction for which a taxpayer pays (directly or indirectly) a fee in any amount to a patent holder or the patent holder's agent for the legal right to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent. A patented transaction also is a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent.

The proposed regulations exclude mathematical calculations or mechanical assistance in the preparation of tax returns from the patented transaction category of reportable transactions. Thus, a patented transaction does not include patent-protected tax preparation software or other tools used to perform or model mathematical calculations or to provide mechanical assistance in the preparation of tax or information returns.

For purposes of the new patented transaction category, a taxpayer has participated in a patented transaction if the taxpayer's tax return reflects a tax benefit from the transaction (including a deduction for fees paid in any amount to the patent holder or patent holder's agent). A taxpayer also has participated in a patented transaction if the taxpayer is the patent holder or patent holder's agent and the taxpayer's tax return reflects a tax benefit in relation to obtaining a patent for a tax planning method (including any deduction for amounts paid to the United States Patent and Trademark Office as required by title 35 of the United States Code and attorney's fees) or reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

These regulations also describe when a person is a material advisor with respect to a patented transaction under section 6111. Because of the nature of patented transactions and how those transactions are marketed, the threshold amount as described in section 6111(b) is reduced from $50,000 to $250 and from $250,000 to $500. A person who is a material advisor with respect to a patented transaction will have a list maintenance obligation under section 6112.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that most information is already required to be reported on the disclosure statement referenced in the regulation and approved under OMB control number 1545–0074; the new information required by these proposed regulations add little or no new burden to the existing requirements. Therefore, a Regulatory Flexibility Analysis under the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules, how they can be made easier to understand, and the administrability of the rules in the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that submits timely written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Michael H. Beker and Charles D. Wien, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6011–4 is amended by:

1. Revising paragraphs (b)(7) and (c)(3)(i)(F).

2. Adding to paragraph (c)(3)(ii) *Examples 4*, *5*, *6*, and *7*.

3. Revising paragraph (h)(2).

The revisions and additions read as follows:

§1.6011–4 Requirement of statement disclosing participation in certain transactions by taxpayers.

* * * * *

(b) * * *

(7) *Patented transactions*—(i) *In general*. A patented transaction is a transaction for which a taxpayer pays (directly or indirectly) a fee in any amount to a patent holder or the patent holder's agent for the legal right to use a tax planning method that the taxpayer knows or has reason to know is the subject of the patent. A patented transaction also is a transaction for which a taxpayer (the patent holder or the patent holder's agent) has the right to payment for another person's use of a tax planning method that is the subject of the patent.

(ii) *Definitions*. For purposes of this paragraph (b)(7), the following definitions apply:

(A) *Fee*. The term *fee* means consideration in whatever form paid, whether in cash or in kind, for the right to use a tax planning method that is the subject of a patent. The term *fee* includes any consideration the taxpayer knows or has reason to know will be paid indirectly to the patent holder or patent holder's agent, such as through a referral fee, fee-sharing arrangement, or license. The term *fee* does not include amounts paid in settlement of, or as the award of damages in, a suit for damages for infringement of the patent.

(B) *Patent*. The term *patent* means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. See §1.1235–2(a). The term *patent* includes patents that have been applied for but not yet granted.

(C) *Patent holder*. A person is a patent holder if—

(*1*) The person is a holder as defined in §1.1235–2(d) and (e);

(*2*) The person would be a holder as defined in §1.1235–2(d)(2) if the phrase *S corporation or trust* was substituted for the word *partnership* and the phrase *shareholder or beneficiary* was substituted for the words *member* and *partner*;

(*3*) The person is an employer of a holder as defined in §1.1235–2(d) and the holder transferred to the employer all substantial rights to the patent as defined in §1.1235–2(b); or

(*4*) The person receives all substantial rights to the patent as defined in §1.1235–2(b) in exchange (directly or indirectly) for consideration in any form.

(D) *Patent holder's agent*. The term *patent holder's agent* means any person who has the permission of the patent holder to offer for sale or exchange, to sell or exchange, or to market a tax planning method that is the subject of a patent. The term *patent holder's agent* also means any person who receives (directly or indirectly) for or on behalf of a patent holder a fee in any amount for a tax planning method that is the subject of a patent.

(E) *Payment*. The term *payment* includes consideration in whatever form paid, whether in cash or in kind, for the right to use a tax planning method that is the subject of a patent. For example, if a patent holder or patent holder's agent receives payment for a patented transaction and a separate payment for another transaction, part or all of the payment for the other transaction may be treated as payment for the patented transaction if the facts and circumstances indicate that the payment for the other transaction is in consideration for the patented transaction. The term *payment* also includes amounts paid in settlement of, or as the award of damages in, a suit for damages for infringement of the patent.

(F) *Tax planning method*. The term *tax planning method* means any plan, strategy, technique, or structure designed to affect Federal income, estate, gift, generation skipping transfer, employment, or excise taxes. A patent issued solely for tax preparation software or other tools used to perform or model mathematical calculations or to provide mechanical assistance in the preparation of tax or information returns is not a tax planning method.

(iii) *Related parties*. For purposes of this paragraph (b)(7), persons who bear a relationship to each other as described in section 267(b) or 707(b) will be treated as the same person.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(F) *Patented transactions*. A taxpayer has participated in a patented transaction, as defined in paragraph (b)(7) of this section, if the taxpayer's tax return reflects a tax benefit from the transaction (including a deduction for fees paid in any amount to the patent holder or patent holder's agent). A taxpayer also has participated in a patented transaction, as defined in paragraph (b)(7) of this section, if the taxpayer is the patent holder or patent holder's agent and the taxpayer's tax return reflects a tax benefit in relation to obtaining a patent for a tax planning method (including any deduction for amounts paid to the United States Patent and Trademark Office as required by title 35 of the United States Code and attorney's fees) or reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

* * * * *

(ii) * * *

Example 4. (i) A, an individual, creates a tax planning method and applies for a U.S. patent. A pays attorney fees in relation to obtaining the patent and A pays the fee required under title 35 of the United States Code for the patent application. Subsequently, C pays a fee to A for the legal right to use the tax planning method that C knows or has reason to know is the subject of A's patent. A's tax return reflects both a deduction for an amount paid in relation to obtaining a patent and income from C's payment to A for the legal right to use the tax planning method that is the subject of the patent. C's tax return reflects a deduction for an amount paid to A for the right to use the tax planning method that is the subject of the patent.

(ii) A is a patent holder under paragraph (b)(7)(ii)(C)(*1*) of this section. The transaction is a reportable transaction for A under paragraph (b)(7) of this section because A has the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for C under paragraph (b)(7) of this section, because C paid a fee to A for the legal right to use a tax planning method that C knew or had reason to know was the subject of a patent. A has participated in the transaction in the year in which A's tax return reflects a tax benefit in relation to obtaining the patent or reflects income from C's payment to A for the legal right to use the tax planning method that is the subject of the patent.

C has participated in the transaction in the year in which C's tax return reflects the deduction for any amount paid to A for the legal right to use the tax planning method that is the subject of the patent. C also participates in the transaction for any years for which any other tax benefit from the transaction is reflected on C's tax return.

Example 5. (i) A, an individual, is the employee of B, a corporation. A creates a tax planning method and applies for a U.S. patent but B pays the fee required under title 35 of the United States Code for A's patent application. Pursuant to A's employment contract with B, B holds all substantial rights to the patent. B's tax return reflects a deduction for the amount paid in relation to obtaining the patent.

(ii) A and B are patent holders under paragraph (b)(7)(ii)(C)(*1*) and (*3*) of this section, respectively. The transaction is not a reportable transaction for A under paragraph (b)(7) of this section because A does not have the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for B under paragraph (b)(7) of this section because B holds all substantial rights to the patent and has the right to payment for another person's use of the tax planning method that is the subject of the patent. B has participated in the transaction in the year in which B's tax return reflects a tax benefit in relation to obtaining the patent. B also participates in the transaction for any years for which B's tax return reflects income from a payment received from another person for the use of the tax planning method that is the subject of the patent.

Example 6. (i) Assume the facts as in *Example 4*, except that A agrees to license the patent to F, a financial institution. The license agreement between A and F provides that F may offer the tax planning method to its clients and if a client decides to use the tax planning method, F must pay A for each client's use of the tax planning method. F offers the tax planning method to G who uses the tax planning method and knows or has reason to know it is the subject of a patent. F charges G for financial planning services and pays A for G's use of the tax planning method. A's tax return reflects income from the payment received from F. F's tax return reflects income from the payment received from G, and G's tax return reflects a deduction for the fees paid to F.

(ii) F is a patent holder's agent under paragraph (b)(7)(ii)(D) of this section because F has the permission of the patent holder to offer for sale or exchange, to sell or exchange, or to market a tax planning method that is the subject of a patent. F also is a patent holder's agent under paragraph (b)(7)(ii)(D) of this section because F receives (directly or indirectly) a fee in any amount for a tax planning method that is the subject of a patent for or on behalf of a patent holder. The transaction is a reportable transaction for both A and F under paragraph (b)(7) of this section because A and F each have the right to payment for another person's use of the tax planning method that is the subject of the patent. The transaction is a reportable transaction for G under paragraph (b)(7) of this section because G paid a fee (directly or indirectly) to a patent holder or a patent holder's agent for the legal right to use a tax planning method that G knew or had reason to know was the subject of the patent. A has participated in the transaction in the years in which A's tax return reflects income from the payment received from F for G's use of the tax planning method that is the subject of the patent. F has participated in the transaction in the years in which F's tax return reflects income from the payment received from G for use of the tax planning method that is the subject of the patent. G has participated in the transaction in the years in which G's tax return reflects a deduction for the fees paid to F. G also participates in the transaction for any years for which any other tax benefit from the transaction is reflected on G's tax return.

Example 7. Assume the same facts as in *Example 4.* J uses a tax planning method that is the same as the tax planning method that is the subject of A's patent. J does not pay any fees to any patent holder or patent holder's agent with respect to the tax planning method that is the subject of the patent. A sues J for infringement of the patent and J pays A an amount for damages. A's tax return reflects as income the amounts for damages received from J. The transaction is not a reportable transaction for J under paragraph (b)(7) of this section because J did not pay any fees (as defined in paragraph (b)(7)(ii)(A) of this section) (directly or indirectly) to a patent holder or patent holder's agent for the legal right to use a tax planning method that J knew or had reason to know was the subject of the patent. A has participated in a reportable transaction under paragraph (b)(7) of this section in the year in which A's tax return reflects income from a payment (the amount received as an award for damages in a suit for damages for infringement of the patent) received from another person for the use of the tax planning method that is the subject of a patent.

* * * * *

(h) * * *

(2) *Patented transactions.* Upon the publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**, paragraphs (b)(7), (c)(3)(i)(F), and (c)(3)(ii) *Examples 4* through *7* of this section will apply to transactions entered into on or after September 26, 2007.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 4. Section 301.6111–3 is amended by revising paragraphs (b)(2)(ii)(E), (b)(3)(i)(C), and (i)(2) to read as follows:

§301.6111–3 Disclosures of reportable transactions.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(E) *Patented transactions.* A statement relates to a tax aspect of a transaction that causes it to be a patented transaction if the statement is made or provided by the patent holder or by the patent holder's agent, as defined in §1.6011–4(b)(7)(ii)(C) or (D) of this chapter, and concerns the tax planning method that is the subject of the patent.

* * * * *

(3) * * *

(i) * * *

(C) *Patented transactions.* For patented transactions described in §1.6011–4(b)(7) of this chapter, the threshold amounts in §301.6111–3(b)(3)(i)(A) are reduced from $50,000 to $250 and from $250,000 to $500.

* * * * *

(i) * * *

(2) *Patented transactions.* Upon the publication of the Treasury decision adopting these rules as final regulations in the Federal Register, paragraphs (b)(2)(ii)(E) and (b)(3)(i)(C) of this section will apply to transactions with respect to which a material advisor makes a tax statement on or after September 26, 2007.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54615)

Section 67 Limitations on Estates or Trusts; Correction

Announcement 2007–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–128224–06, 2007–36 I.R.B. 551) that was published in the **Federal Register** on Friday, July 27, 2007 providing guidance on which costs incurred by estates or non-grantor trusts are subject to the 2-percent floor for miscellaneous itemized deductions under section 67(a).

FOR FURTHER INFORMATION CONTACT: Jennifer N. Keeney at (202) 622–3060.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–128224–06) that is the subject of these corrections is under section 67 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–128224–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–128224–06) that was the subject of FR. Doc. E7–14489 is corrected as follows:

On page 41245, column 1, in the preamble, under the paragraph heading "Drafting Information", line 3, the language "of the Office of Associate Chief Counsel" is corrected to read "of the Associate Chief Counsel".

LaNita Van Dyke,
Branch Chief,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on August 22, 2007, 8:45 a.m., and published in the issue of the Federal Register for August 23, 2007, 72 F.R. 48248)

Public Inspection of Material Relating to Tax-Exempt Organizations; Correction

Announcement 2007–97

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to proposed regulations (REG–116215–07, 2007–38 I.R.B. 659) that amend existing regulations issued under sections 6104 and 6110. These regulations clarify rules relating to information that is made available by the IRS for public inspection under section 6104(a) and materials that are made publicly available under section 6110.

FOR FURTHER INFORMATION CONTACT: Mary Ellen Keys, (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–116215–07) that is the subject of these corrections are under sections 6110 and 6104(a) of the Internal Revenue Code.

Need for Correction

As published, this notice of proposed rulemaking (REG–116215–07) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–116215–07) that was the subject of FR. Doc. E7–15952 is corrected as follows:

1. On page 45394, column 2, in the preamble, under the caption heading "SUMMARY:", line 11 from the bottom of the paragraph, the language "denied or revoked an organization's tax" is corrected to read "denied or revoked an organization's tax-".

2. On page 45394, column 2, in the preamble, under the caption heading "ADDRESSES:", line 2 from the bottom of the column, the language "NW., Washington, DC, or sent" is corrected to read "NW., Washington, DC 20224, or sent".

3. On page 45394, column 3, in the preamble, under the paragraph heading "Background", paragraph 2, line 7, the language "tax exempt status from the public" is corrected to read "tax-exempt status from the public".

4. On page 45395, column 1, in the preamble, line 7 from the bottom of the first paragraph of the column, the language "public. See AOD 2004–02, 2004–29 IRB is corrected to read "See AOD 2004–2, 2004–29 I.R.B.".

5. On page 45395, column 1, in the preamble, under the paragraph heading "*Explanation of Provisions*", line 4 from the bottom of paragraph 1, the language "sections 509(a), 4942(j)(3), or 4943(f), is corrected to read "section 509(a), 4942(j)(3), or 4943(f),".

6. On page 45395, column 2, in the preamble, under the paragraph heading "*Other Changes to the Existing Regulations*", paragraph 6, line 3, the language "disclose, in response to or anticipation" is corrected to read "in response to or in anticipation".

7. On page 45395, column 2, in the preamble, under the paragraph heading "*Other Changes to the Existing Regulations*", paragraph 7, line 5 from the bottom of the column, the language "organizations whose tax exempt status" is corrected to read "organizations whose tax-exempt status".

§ 301.6104(a)–1 [Corrected]

8. On page 45396, column 2, § 301.6104(a)–1(c)(4), line 4, the language "organization described in sections" is corrected to read "organization described in section".

9. On page 45396, column 3, § 301.6104(a)–1(c)(2), line 4 from the bottom of the paragraph, the language "Procedure 2007–52, 2007–30 IRB 222, is corrected to read "Procedure 2007–52, 2007–30 I.R.B. 222,".

10. On page 45396, column 3, § 301.6104(a)–1(e)(3), line 4 from the bottom of the paragraph, the language "Procedure 80–27, 1980–1CB 677, and" is corrected to read "Procedure 80–27, 1980–1 C.B. 677, and".

LaNita Van Dyke,
Branch Chief,
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(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54618)

Medical and Accident Insurance Benefits Under Qualified Plans; Correction

Announcement 2007–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to notice of proposed rulemaking (REG–148393–06, 2007–39 I.R.B. 714) that was published in the **Federal Register** on Monday, August 20, 2007 (72 FR 46421), regarding the tax treatment of payments by qualified plans for medical or accident insurance.

FOR FURTHER INFORMATION CONTACT: Pamela Kinard at (202) 622–6060.

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–148393–06) that is the subject of these corrections is under section 402(a) of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–148393–06) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–148393–06) that was the subject of FR. Doc. E7–16084 is corrected as follows:

1. On page 46423, column 3, in the preamble, under the paragraph heading "*Explanation of Provisions*", paragraph 2, lines 11 and 12, the language "to provide medical benefits in section 401(h) under a qualified plan or annuity" is corrected to read "to provide medical benefits in a section 401(h) account under a qualified plan or annuity".

2. On page 46424, column 1, in the preamble, under the paragraph heading "*Explanation of Provisions*", paragraph 3, line 22, the language "Public Lic 108–311" is corrected to read "Public Law 108–311".

§ 1.402(a)–1 [Corrected]

3. On page 46425, column 2, § 1.402(a)–1, lines 1 and 2, the language "(a) * * * (1) * * * (i) * * * " is corrected to read "(a) * * * (1)(i) * * * "

4. On page 46425, column 2, § 1.402(a)–1(a)(1)(ii), lines 3 and 4, the language "qualified pension, annuity, profit sharing, or stock bonus plan to provide" is corrected to read "qualified pension, annuity, profit-sharing, or stock bonus plan to provide."

5. On page 46425, column 2, § 1.402(a)–1(e), line 3, the language "profit sharing, or stock bonus plan—(1)" is corrected to read "profit-sharing, or stock bonus plan—(1)".

6. On page 46426, column 1, § 1.402(a)–1(e)(6), paragraph (ii) of *Example.*, line 3, the language "the $1,000 constitutes a distribution under" is corrected to read "$1,000 constitutes a distribution under".

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Foundations Status of Certain Organizations

Announcement 2007–99

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Absolute Beginnings, Inc., Gibson, NC
African Trade Center, Plano, TX
All Things Through Christ Ministries, Fresno, TX
American Institute of Research, Inc., McLean, VA
Avoyelles Parish Medical Society Association, Marksville, LA
Belize Musical Action Commission, Inc., Richmond, VA
Bethany Lutheran Ministries, Inc., Indianapolis, IN
Bethlehem Community Development Corporation, Inc., Osceola, AR
Beyond the Church Ministries, Kansas City, MO
Bibleway Community Outreach Center, Detroit, MI
Brotherhood of the Balloon, Inc., Mattapoisett, MA
BSR Racing Scholarship Fund, Inc., Port Orange, FL
Buddhist Society of Contemplative Living, Inc., Stuart, FL
Canaan Community Development Center, Ahoskie, NC
Center for Alternative Dispute Resolution Education, Inc., Westlake Village, CA
Christian Management Resources and Development, Inc., St. Louis, MO
Community Outreach Corporation, West Berlin, NJ
Cornerstone Community Development Corporation, Anniston, AL
Covenant One Organization, Bloomingdale, IL
C.V. Russell Sr. Multipurpose Center, Inc., Portsmouth, VA
Dalit Solidarity Forum in the USA, Inc., Oakland, NJ
Edie Action Development Services, Inc., St. Paul, MN
Elite Element Academy, Inc., Honolulu, HI

Empire Community Development Corporation, Southfield, MI
Environmental Relief Center, Studio City, CA
Fayette County, Uniontown, PA
First Impression Second Chance, Chillicothe, OH
Four Gospel Ministry, Inc., Cincinnati, OH
Fulton Families First, Inc., Fulton, KY
G to G Mission Homes, Gastonia, NC
George Roskrudge & S. Barry Casey Masonic Memorial Library & Museum, Phoenix, AZ
Gods Lady Ministry, Youngstown, OH
Good Life Health and Service, Omaha, NE
Gray's Creek Outreach Community Service Ministry, Inc., Arlington, TN
Haas Academic Research Foundation, Menlo Park, CA
Hands of Joy Youth Services, Inc., Statesville, NC
Hartleys Community Training Academy, Lake Charles, LA
Healthcare Justice Education Fund, St. Louis, MO
Hebrew Language and Cultural Center of Manhattan, New York, NY
Help a Family Out Reach, Peoria, IL
Hemet Valley Medical Center, Hemet, CA
Henry K. Lindsey Foundation, Hilo, HI
HIV Anonymous, San Clemente, CA
Holiness Unto the Lord Ministry, Inc., Oakland, MI
Hollywood RHF Housing, Inc., Long Beach, CA
HRH Computer Learning Center, Youngstown, OH
Hunterbrook Ridge at Fieldhome, Inc., Yorktown Heights, NY
Hunter's Brotherhood Alumni Alumnae, Inc., New Orleans, LA
I Had a Dream Foundation, Ft. Lauderdale, FL
In Music We Trust (NFP), Chicago, IL
International Transplant-Skin Cancer Collaborative, Milwaukee, WI
Iola Old Car Show Foundation, Inc., Iola, WI
J & J Foundation, Malibu, CA
Jamaica Progressive League, Inc., Upper Darby, PA
Jes-Us, Inc., Los Angeles, CA
Johnny Rodgers Youth Foundation, Omaha, NE
Kansas City Business Center for Entrepreneurial Development, Kansas City, KS
Kems House, Bartlett, TN
Lees Gentle Touch Adult Day Care Health Rehab Services, Houston, TX
Linda's Life Skills and Mentorship Program, Cedar Hill, TX
Long Island Physicians Assistants, Inc., Commack, NY
Mason Temple Community Economic Development Corporation, Conway, SC
Medical Mission Exchange, Thetford Center, VT
MIA Health Center, Inc., Los Angeles, CA
Mighty Warrior, Inc., Yorba Linda, CA
Mississippi Workforce Education Social Development Centers, Inc., Meridian, MS
Mount Pleasant Community Development Corporation, Inc., Baltimore, MD
Multi-County Child and Family Services (MCCFS), Forrest City, AR
Muse Foundation of New York, Inc., New York, NY
National Center for Behavioral Health Solutions, San Antonio, TX
National Council of Minority Arts, Fresno, CA
National Health & Education Association, Inc., Kennesaw, GA
National Resource Center for Deafblindness, Pineville, NC
No Limit Press, Inc., San Mateo, CA
Officer Brian A. Aselton Memorial Scholarship Fund, Glastonbury, CT
On My Way, Atlanta, GA
Oneill Theater Project Plus N F P, Berwyn, IL
Paducah Homeownership Program, Inc., Paducah, KY
Paths to the Promise, Institute, WV
Paul T. OConnor Foundation, Inc., Houston, TX
Phoenix Agenda Foundation, Fairlawn, OH
Platte River Habitat Foundation, Inc., Kearney, NE
Poly Booster Club, Sun Valley, CA
Porter Broadcasting Network, Inc., Rocky Mount, NC
Power Circle Development Association, Chicago, IL
Rabboni Retirement Villa, Los Angeles, CA
Recovery Care Solutions, Cumberland, MD
Repairing the Breaches Family Services Ministry, Inc., Bloomfield, CT
Research and Service Foundation, Opa Locka, FL
RUB, Inc., Weehawken, NJ
Sanctuary of Christ, Inc., Brandon, FL
Scholastic Outreach Services, Inc., Houston, TX
Shas Chabura, Inc., Lakewood, NJ
Sidney Park Outreach Ministries, Inc., Columbia, SC
Silver Center, Inc., Guyten, GA
Soundview Senior Housing Development Fund Company, St. Albans, NY
Sports Foundation of America, Inc., Spring Lake, NJ
Student Program for Academic and Athletic Transitioning, Oakland, CA
Sunshine Children and Family Development, Inc., Victorville, CA
Team Morris, Orange Park, FL
Tehachapi Mountain Boys Home, Tehachapi, CA
Texas Music Library & Research Center, Houston, TX
Touched by Angel Youth Foundation, Los Angeles, CA
Universal Christian Revivalist, Harvey, LA
Valhalla Animal Sanctuary, Inc., Cable, OH
Virtuous Women of Valor Association, Birmingham, AL
Walking in Faith Ministries, Brooklyn Park, MN
Wind of the Spirit Community Services, Inc., Rancho Cucamonga, CA
Winners Choice Center, San Antonio, TX
World Café Community Foundation, Mill Valley, CA
Worldwide Christian University, Inc., Oklahoma City, OK
Youth Awareness Foundation, Detroit, MI

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Exclusions From Gross Income of Foreign Corporations; Hearing Cancellation

Announcement 2007–101

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Cancellation of notice of public hearing on proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document cancels a public hearing on proposed regulations (REG–138707–06, 2007–32 I.R.B. 342) relating to income derived by foreign corporations from the international operation of ships or aircraft.

DATES: The public hearing, originally scheduled for October 24, 2007 at 10 a.m. is cancelled.

FOR FURTHER INFORMATION CONTACT: Kelly Banks of the Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration) at (202) 622–0392 (not a toll-free number).

SUPPLEMENTARY INFORMATION: A notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing (REG–138707–06) that appeared in the **Federal Register** on Monday, June 25, 2007 (72 FR 34650), announced that a public hearing was scheduled for October 24, 2007, at 10 a.m. in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. The subject of the public hearing is under section 883 of the Internal Revenue Code.

The public comment period for these regulations expired on September 24, 2007. The notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing instructed those interested in testifying at the public hearing to submit a request to speak and an outline of the topics to be addressed by September 24, 2007. As of September 28, 2007, no one has requested to speak and therefore, the public hearing scheduled for October 24, 2007, is cancelled.

LaNita Van Dyke,
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(Filed by the Office of the Federal Register on October 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2007, 72 F.R. 57503)

Part III. Administrative, Procedural, and Miscellaneous

Interest Rate Modification

Notice 2007–81

This notice provides guidance on the corporate bond yield curve and the segment rates required to compute the funding target and other items under § 430 of the Internal Revenue Code of 1986 (Code) and § 303 of the Employee Retirement Income Security Act of 1974 (ERISA). In addition, this notice provides guidance on the interest rates for determining minimum present values as required under § 417(e)(3) of the Code and § 205(g)(3) of ERISA. This notice implements changes to the funding rules and minimum present value requirements made by sections 101, 102, 111, 112, and 302 of the Pension Protection Act of 2006, P.L. No. 109–280 (PPA).

BACKGROUND AND PRIOR LAW

Section 412 of the Code provides minimum funding requirements that generally apply for defined benefit plans. Under § 412(b)(5)(A) prior to amendment by PPA, the funding standard account (and items therein) must be charged or credited with interest at the appropriate rate consistent with the rate or rates of interest used under the plan to determine costs.

Section 412(b)(5)(B) prior to amendment by PPA provides rules for specifying the interest rate that is used to determine a plan's current liability for purposes of § 412(l) and for purposes of the minimum full funding limitation under § 412(c)(7)(E). Section 412(b)(5)(B)(ii)(III) prior to amendment provides that, for plan years beginning in 2004, 2005, 2006, and 2007, the interest rate used to determine current liability must not be above and must not be more than 10 percent below the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year. Notice 2004–34, 2004–1 C.B. 848, specified the corporate bond indices and the methodology for determining these corporate bond rates.

Section 417(e)(3) provides assumptions for determining minimum present values for certain purposes. For plan years beginning before 2008, the applicable interest rate for these purposes is the annual rate of interest on 30-year Treasury securities as prescribed by the Commissioner.

PENSION PROTECTION ACT OF 2006

PPA makes extensive changes to the minimum funding requirements that generally apply for plan years beginning on or after January 1, 2008. However, certain plans have delayed effective dates for these amendments provided under sections 104, 105, and 106 of PPA.

Section 430 of the Code, added by section 112 of PPA, specifies the minimum funding requirements that apply to single employer plans pursuant to § 412 of the Code. Section 430(a) defines the minimum required contribution for a single employer plan as the sum of the plan's target normal cost and the shortfall and waiver amortization charges for the year. Under § 430(b), a plan's target normal cost is generally equal to the present value of all benefits expected to accrue or be earned under the plan during the plan year. Under § 430(d)(1), a plan's funding target for a plan year is generally equal to the present value of all benefits accrued or earned under the plan as of the beginning of the plan year.

Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three interest rates ("segment rates"), each of which applies to cash flows during specified periods.

Each segment rate is, for any month, the single rate of interest determined by the Secretary for such month on the basis of the applicable corporate bond yield curve for that month, taking into account only that portion of such yield curve applicable to that segment. Section 430(h)(2)(D)(i) provides that the Secretary shall prescribe a corporate bond yield curve applicable for each month. The applicable corporate bond yield curve is, with respect to any month, a yield curve which reflects a 24-month average (the average of the yield curve values for the preceding month and the prior 23 months) of the yields on investment grade corporate bonds with varying maturities and that are in the top 3 quality levels available. Under § 430(h)(2)(D)(ii), an election may be made to use the corporate bond yield curve determined without regard to the 24-month averaging in lieu of the segment rates.

A transitional rule under § 430(h)(2)(G) applies for plan years starting in 2008 and 2009 (if the plan had its first plan year before 2008). Under this rule, the 24-month average segment rates as computed above are blended with the corporate bond weighted average rates determined under § 412(b)(5)(B)(ii)(II) (prior to amendment). However, § 430(h)(2)(G)(iv) provides that an election may be made to apply the 24-month average segment rates without applying the blended rates under the transitional rule of § 430(h)(2)(G).

Generally, section 302(b) of PPA amends § 417(e)(3) of the Code to provide that the interest rates used for the determination of minimum present values are segment rates as computed under § 430(h)(2), but determined without regard to yield curve rates from the preceding 23 months. However, for plan years beginning in 2008, 2009, 2010, and 2011 these segment rates are blended with the applicable rate of § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. This amendment is effective for plan years beginning after December 31, 2007. PPA provides conforming amendments to ERISA for the amendments to §§ 412, 417, and 430 of the Code.

Section 430(h)(2)(F) provides that the Secretary shall publish each month the corporate bond yield curve and the rates described above. In addition, the Secretary shall publish a description of the methodology used to determine such yield curve and such rates in sufficient detail to enable plans to make reasonable predictions regarding the yield curve and rates for future months.

DETERMINATION OF THE SEGMENT RATES

The following methodology is established to determine the corporate bond yield curve and the segment rates. A yield curve is calculated for each business day

of the month based on investment grade corporate bonds in the top three quality levels. The construction of the yield curve for a given day is explained in Appendix A to this notice. This daily yield curve is expressed as the yield for a zero coupon bond at each maturity point from 1/2 year to 100 years, in 1/2 year intervals. The value at any maturity point of the monthly yield curve is set equal to the arithmetic average for all of the business days in a month of the values for that maturity point from the daily yield curves. The monthly yield curve then is the set of values for each of the 200 maturity points. The monthly corporate bond yield curve derived from August 2007 data is shown in Table I of Appendix B. The monthly corporate bond yield curve is the table which would be used if an election is made under § 430(h)(2)(D)(ii).

The first segment rate applicable for a given month is the arithmetic average over the 10 maturity points from 1/2 year to 5 years of the applicable corporate bond yield curve. This is mathematically the same as the arithmetic average for the preceding 24 months of the "spot" first segment rates that can be developed from each of the monthly yield curves (as the arithmetic average over the 10 maturity points from 1/2 year to 5 years of those monthly yield curves) and this second approach has been used in order to facilitate presentation of the segment rates. Similarly, the second segment rate applicable for the given month is the arithmetic average for the preceding 24 months of the spot second segment rates for those months (where the spot second segment rate for a month is the arithmetic average over the 30 maturity points from 5 1/2 years to 20 years of the monthly yield curve). The third segment rate applicable for the given month is the arithmetic average for the preceding 24 months of the spot third segment rates for those months (where the spot third segment rate for a month is the arithmetic average over the 80 maturity points from 20 1/2 years to 60 years of the monthly yield curve). These 24-month average segment rates are the rates that would be applicable if an election was made under § 430(h)(2)(G)(iv) not to use the transitional rule of § 430(h)(2)(G), or if a plan's first plan year begins after 2007. The three 24-month average corporate bond segment rates applicable for September 2007 are as follows:

24-Month Average Segment Rates
Applicable For September 2007

First Segment	Second Segment	Third Segment
5.26	5.82	6.38

The funding transitional segment rates determined under § 430(h)(2)(G) applicable for September 2007, taking into account the corporate bond weighted average of 5.86 for September 2007 published in Notice 2007–68, 2007–35 I.R.B. 468, are as follows:

Funding Transitional Segment Rates
Applicable For September 2007

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.66	5.85	6.03

INTEREST RATE FOR MINIMUM PRESENT VALUE

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3) are segment rates computed without regard to a 24-month average. These are the monthly spot segment rates. For plan years beginning in years 2008, 2009, 2010, and 2011, the applicable interest rate is the monthly spot segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007, where the blending ratio depends on the plan year. The minimum present value transitional segment rates determined under § 417(e)(3)(D) for August 2007, taking into account the August 2007 30-year Treasury rate of 4.93 published in Notice 2007–68, are as follows:

Minimum Present Value Transitional Segment Rates
For August 2007

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.02	5.18	5.28

SUPPLEMENTAL INFORMATION

The spot first, second, and third segment rates for August 2007 are, respectively, 5.40, 6.20, and 6.66. The spot segment rates for each of the months from September 2005 through August 2007 are shown in Table II of Appendix B. These rates are preliminary values from which the 24-month average segment rates and the minimum present value transitional segment rates provided above can be derived.

MONTHLY PUBLICATION OF RATES

Each month, the Service publishes by notice the corporate bond weighted average applicable for the current month as provided under § 412(b)(5)(B) prior to amendment by PPA and the 30-year Treasury rate as provided under § 417(e)(3). In the same notice, the Service will publish the monthly corporate bond yield curve of § 430(h)(2) derived from the preceding month (and the corresponding spot segment rates), the 24-month average funding segment rates applicable for the current month, and the funding transitional segment rates under the transition rule of § 430(h)(2)(G) applicable for the current month. In the same notice, the Service will also publish the minimum present value segment rates as required under the transitional rule provided in § 417(e)(3)(D).

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Service and the Treasury Department participated in preparing this notice. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

APPENDIX A

The daily yield curve for a given day is constructed under methods and assumptions as described in this section. The description applies to the methodology in use at the present time. Any significant changes in this methodology will be announced by notice.

Data Set

The following criteria are provided for identifying those bonds to be included in the database used to construct the yield curve. The universe of possible bonds consists of a set of bonds which are designated as corporate, have high quality ratings (AAA, AA, or A) from nationally recognized statistical rating organizations, and have at least $250 million in par amount outstanding on at least one day during the reporting period. The database is extended for maturities below 1 year by using AA financial and AA non-financial commercial paper rates, as reported by the Federal Reserve Board. The bonds chosen for the bond set pay fixed nominal semiannual coupons and the principal amount at maturity. Bonds with different or additional characteristics are generally excluded. The main exclusions are:

(1) bonds not denominated in U.S. dollars;

(2) bonds not issued by U.S. corporations;

(3) bonds which are capital securities (hybrid preferred stock);

(4) bonds having variable coupon rates;

(5) convertible bonds;

(6) “Agency” bonds, such as FNMA bonds;

(7) asset-backed bonds;

(8) callable bonds unless the call feature is make-whole;

(9) putable bonds; and

(10) bonds with sinking funds.

In addition, a bond is excluded from use with respect to a given day if the bond has for that day:

(1) a par amount outstanding below $250 million;

(2) a maturity greater than 30 years; or

(3) a rating below A.

These criteria leave about 1,400 bonds in each daily set of bonds. For each day, the database information for each bond includes the bid price (for commercial paper, it is the ask price), coupon rate, maturity, par amount outstanding, and ratings.

Derivation of the Yield Curve

The daily yield curve is derived from a pricing model that gives the price of a bond as the discounted present value of its cash flows plus adjustment factors for credit quality. The results of the model generate a discount function, and the rates for the daily yield curve are calculated from the discount function. The discount function is derived from the daily determination of the instantaneous forward interest rates for each point in the future.

Derivation of Forward Interest Rates

The forward interest rates are assumed to be described as a series of cubic polynomials that are smoothly joined at specified knot points. The specified knot points are maturities of 0, 1.5, 3, 7, 15, and 30 years, and having a smooth junction at a knot means that the two polynomials that are meeting at the knot have the same value, the same derivative, and the same second derivative at that knot point. Such a series of cubic polynomials is called a cubic spline.

Three constraints are placed on the forward interest rate function. First, the second derivative of the function is set to zero at maturity zero. Second, the value of the forward rate function at and after 30 years is constrained to equal its average value from 15 to 30 years. Third, the derivative of the forward rate function is set to zero at maturity 30 years.

Using these constraints, the assumed cubic spline for the forward interest rate function can be described as a linear combination of B-splines, with five parameters. Thus, the daily forward rate function can be defined by determining the five daily parameters for the B-splines. These parameters, together with two adjustment factors described below, are estimated from the bond data.

Adjustment Factors for Credit Quality

In the pricing model, the adjustment factors for credit quality are added to the present value of the bond's cash flows as given by the forward rate and the discount function. Specifically, the adjustment factors are made up of two linear regression variables added to the present value with two respective regression coefficients that need to be estimated. These variables adjust the bond prices so that the discount function and the spot rates represent market-weighted average credit quality of the top three quality levels (AAA, AA, and A).

Specifically, some of the deviation between the predicted price for the bond (based on the cash flows and the discount function) and the actual price for the bond can be attributed to differences in credit quality and some of the deviation is an error factor. The model determines the portion of the deviation that is attributable to credit quality by determining the two adjustment factors that reflect the relative proportion of A-rated bonds within the data set and the relative proportion of AA-rated bonds within the subset of AA- and AAA-rated bonds. A high proportion of A-rated bonds results in a larger deviation in price for the higher quality bonds, which means that the discount function used to develop the yield curve is more closely aligned with a discount function for A-rated bonds than for the higher rated bonds. Similarly, a higher proportion of AA-rated bonds within the subset of AA- and AAA-rated bonds means that the discount function is more representative of the AA-rated universe than the AAA-rated bonds.

These adjustment factors allow the yield curve to be based on the proportion of bonds at the three quality levels in the market determined over the entire maturity spectrum (rather than on the proportion at each specific maturity point). This avoids potential distortions which could arise because of different proportions of bonds at the three quality levels at various maturity points.

Estimates for the parameters

These seven parameters, comprising five parameters in the cubic spline and the two adjustment coefficients on the bond-quality adjustment variables, are estimated from the bond price data. The estimation is done by nonlinear least squares, that is, the seven parameter estimates are chosen to minimize the sum of the squared differences between the actual bond prices and the prices given by the bond price model.

Before the estimation is carried out, the bond data are weighted. The weighting consists of two stages. In the first stage, equal weights are assigned to the commercial paper rates at the short end of the curve, and the par amounts outstanding of all the bonds are rescaled so that their sum equals the sum of the weights for commercial paper. Then, the squared price difference for each bond is multiplied by the bond's rescaled par amount outstanding, and the squared difference for each commercial paper rate is multiplied by the commercial paper weight. In the second stage, for bonds with duration greater than 1, the weighted squared price difference for each bond from the first stage is divided by duration.

Additional Information

Additional background information regarding the daily corporate bond yield curve can be found at the following URL:

http://www.ustreas.gov/offices/economic-policy/reports/corporate_yield_curve_2007.pdf

Other developmental papers on the corporate bond yield curve can be found at the following URL:

http://www.ustreas.gov/offices/economic-policy/speeches_testimony_refund.shtml

APPENDIX B

Table I

Monthly Yield Curve Derived From August 2007 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	5.47	20.5	6.49	40.5	6.68	60.5	6.75	80.5	6.78
1.0	5.37	21.0	6.50	41.0	6.69	61.0	6.75	81.0	6.78
1.5	5.29	21.5	6.51	41.5	6.69	61.5	6.75	81.5	6.78
2.0	5.26	22.0	6.51	42.0	6.69	62.0	6.75	82.0	6.78
2.5	5.28	22.5	6.52	42.5	6.69	62.5	6.75	82.5	6.79
3.0	5.33	23.0	6.53	43.0	6.70	63.0	6.75	83.0	6.79
3.5	5.40	23.5	6.54	43.5	6.70	63.5	6.76	83.5	6.79
4.0	5.47	24.0	6.55	44.0	6.70	64.0	6.76	84.0	6.79
4.5	5.54	24.5	6.55	44.5	6.70	64.5	6.76	84.5	6.79
5.0	5.62	25.0	6.56	45.0	6.70	65.0	6.76	85.0	6.79
5.5	5.69	25.5	6.57	45.5	6.71	65.5	6.76	85.5	6.79
6.0	5.75	26.0	6.57	46.0	6.71	66.0	6.76	86.0	6.79
6.5	5.81	26.5	6.58	46.5	6.71	66.5	6.76	86.5	6.79
7.0	5.86	27.0	6.58	47.0	6.71	67.0	6.76	87.0	6.79
7.5	5.91	27.5	6.59	47.5	6.71	67.5	6.76	87.5	6.79
8.0	5.95	28.0	6.59	48.0	6.71	68.0	6.76	88.0	6.79
8.5	6.00	28.5	6.60	48.5	6.72	68.5	6.77	88.5	6.79
9.0	6.04	29.0	6.60	49.0	6.72	69.0	6.77	89.0	6.79
9.5	6.07	29.5	6.61	49.5	6.72	69.5	6.77	89.5	6.79
10.0	6.11	30.0	6.61	50.0	6.72	70.0	6.77	90.0	6.79
10.5	6.14	30.5	6.62	50.5	6.72	70.5	6.77	90.5	6.79
11.0	6.17	31.0	6.62	51.0	6.72	71.0	6.77	91.0	6.79
11.5	6.19	31.5	6.63	51.5	6.73	71.5	6.77	91.5	6.79
12.0	6.22	32.0	6.63	52.0	6.73	72.0	6.77	92.0	6.80
12.5	6.24	32.5	6.63	52.5	6.73	72.5	6.77	92.5	6.80
13.0	6.27	33.0	6.64	53.0	6.73	73.0	6.77	93.0	6.80
13.5	6.29	33.5	6.64	53.5	6.73	73.5	6.77	93.5	6.80
14.0	6.31	34.0	6.65	54.0	6.73	74.0	6.77	94.0	6.80
14.5	6.33	34.5	6.65	54.5	6.73	74.5	6.77	94.5	6.80
15.0	6.34	35.0	6.65	55.0	6.74	75.0	6.78	95.0	6.80
15.5	6.36	35.5	6.66	55.5	6.74	75.5	6.78	95.5	6.80
16.0	6.38	36.0	6.66	56.0	6.74	76.0	6.78	96.0	6.80
16.5	6.39	36.5	6.66	56.5	6.74	76.5	6.78	96.5	6.80
17.0	6.41	37.0	6.66	57.0	6.74	77.0	6.78	97.0	6.80
17.5	6.42	37.5	6.67	57.5	6.74	77.5	6.78	97.5	6.80
18.0	6.43	38.0	6.67	58.0	6.74	78.0	6.78	98.0	6.80
18.5	6.44	38.5	6.67	58.5	6.75	78.5	6.78	98.5	6.80
19.0	6.46	39.0	6.68	59.0	6.75	79.0	6.78	99.0	6.80
19.5	6.47	39.5	6.68	59.5	6.75	79.5	6.78	99.5	6.80
20.0	6.48	40.0	6.68	60.0	6.75	80.0	6.78	100.0	6.80

Table II

Historical Spot Segment Rates

Month	Year	First Segment	Second Segment	Third Segment
September	2005	4.44	5.23	6.05
October	2005	4.78	5.50	6.27
November	2005	4.95	5.60	6.34
December	2005	4.96	5.54	6.24
January	2006	4.96	5.49	6.14
February	2006	5.19	5.61	6.09
March	2006	5.27	5.77	6.31
April	2006	5.43	6.06	6.67
May	2006	5.52	6.19	6.79
June	2006	5.67	6.21	6.78
July	2006	5.67	6.19	6.75
August	2006	5.46	5.98	6.59
September	2006	5.32	5.81	6.42
October	2006	5.33	5.81	6.36
November	2006	5.25	5.64	6.07
December	2006	5.16	5.60	6.09
January	2007	5.35	5.78	6.22
February	2007	5.31	5.76	6.13
March	2007	5.13	5.68	6.19
April	2007	5.23	5.81	6.34
May	2007	5.32	5.85	6.32
June	2007	5.58	6.21	6.61
July	2007	5.53	6.22	6.60
August	2007	5.40	6.20	6.66

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2007–82

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period

ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for September 2007 is 6.23 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted Average	Permissible Range		
Month	*Year*		90%	to	100%
October	2007	5.88	5.29		5.88

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. For plan years beginning in 2008 and 2009, a transitional rule under § 430(h)(2)(G) provides that the segment rates are blended with the corporate bond weighted average as specified above. An election may be made under § 430(h)(2)(G)(iv) to use the segment rates without applying the transitional rule.

Notice 2007–81, this Bulletin, provides guidelines for determining the monthly corporate bond yield curve, the 24-month average corporate bond segment rates, and the funding transitional segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from September 2007 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of September 2007 are, respectively, 5.28, 6.12, and 6.55. The three 24-month average corporate bond segment rates applicable for October 2007 under the election of § 430(h)(2)(G)(iv) are as follows:

First Segment	Second Segment	Third Segment
5.29	5.86	6.40

The transitional segment rates under § 430(h)(2)(G) applicable for October 2007, taking into account the corporate bond weighted average of 5.88 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.68	5.87	6.05

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for September 2007 is 4.79 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in May 2037.

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable

interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24 month average. For plan years beginning in 2008 through 2011, the applicable interest rate is the monthly spot segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for September 2007, taking into account the September 2007 30-year Treasury rate of 4.79 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	4.89	5.06	5.14

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for September 2007

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	5.30	20.5	6.40	40.5	6.57	60.5	6.63	80.5	6.66
1.0	5.21	21.0	6.41	41.0	6.57	61.0	6.63	81.0	6.66
1.5	5.16	21.5	6.42	41.5	6.58	61.5	6.63	81.5	6.66
2.0	5.14	22.0	6.42	42.0	6.58	62.0	6.63	82.0	6.66
2.5	5.16	22.5	6.43	42.5	6.58	62.5	6.63	82.5	6.66
3.0	5.22	23.0	6.44	43.0	6.58	63.0	6.63	83.0	6.66
3.5	5.29	23.5	6.44	43.5	6.58	63.5	6.64	83.5	6.66
4.0	5.37	24.0	6.45	44.0	6.59	64.0	6.64	84.0	6.66
4.5	5.45	24.5	6.46	44.5	6.59	64.5	6.64	84.5	6.66
5.0	5.53	25.0	6.46	45.0	6.59	65.0	6.64	85.0	6.66
5.5	5.60	25.5	6.47	45.5	6.59	65.5	6.64	85.5	6.66
6.0	5.66	26.0	6.47	46.0	6.59	66.0	6.64	86.0	6.66
6.5	5.72	26.5	6.48	46.5	6.59	66.5	6.64	86.5	6.67
7.0	5.78	27.0	6.48	47.0	6.60	67.0	6.64	87.0	6.67
7.5	5.83	27.5	6.49	47.5	6.60	67.5	6.64	87.5	6.67
8.0	5.88	28.0	6.49	48.0	6.60	68.0	6.64	88.0	6.67
8.5	5.92	28.5	6.50	48.5	6.60	68.5	6.64	88.5	6.67
9.0	5.96	29.0	6.50	49.0	6.60	69.0	6.64	89.0	6.67
9.5	6.00	29.5	6.51	49.5	6.60	69.5	6.64	89.5	6.67
10.0	6.04	30.0	6.51	50.0	6.60	70.0	6.65	90.0	6.67
10.5	6.07	30.5	6.51	50.5	6.61	70.5	6.65	90.5	6.67
11.0	6.10	31.0	6.52	51.0	6.61	71.0	6.65	91.0	6.67
11.5	6.13	31.5	6.52	51.5	6.61	71.5	6.65	91.5	6.67
12.0	6.15	32.0	6.52	52.0	6.61	72.0	6.65	92.0	6.67
12.5	6.18	32.5	6.53	52.5	6.61	72.5	6.65	92.5	6.67
13.0	6.20	33.0	6.53	53.0	6.61	73.0	6.65	93.0	6.67
13.5	6.22	33.5	6.53	53.5	6.61	73.5	6.65	93.5	6.67
14.0	6.24	34.0	6.54	54.0	6.62	74.0	6.65	94.0	6.67
14.5	6.26	34.5	6.54	54.5	6.62	74.5	6.65	94.5	6.67
15.0	6.27	35.0	6.54	55.0	6.62	75.0	6.65	95.0	6.67
15.5	6.29	35.5	6.55	55.5	6.62	75.5	6.65	95.5	6.67
16.0	6.30	36.0	6.55	56.0	6.62	76.0	6.65	96.0	6.67
16.5	6.32	36.5	6.55	56.5	6.62	76.5	6.65	96.5	6.67
17.0	6.33	37.0	6.55	57.0	6.62	77.0	6.65	97.0	6.67
17.5	6.34	37.5	6.56	57.5	6.62	77.5	6.66	97.5	6.67
18.0	6.35	38.0	6.56	58.0	6.62	78.0	6.66	98.0	6.67
18.5	6.36	38.5	6.56	58.5	6.63	78.5	6.66	98.5	6.68
19.0	6.37	39.0	6.56	59.0	6.63	79.0	6.66	99.0	6.68
19.5	6.38	39.5	6.57	59.5	6.63	79.5	6.66	99.5	6.68
20.0	6.39	40.0	6.57	60.0	6.63	80.0	6.66	100.0	6.68

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Withdrawal of Proposed Regulations

Consolidated Returns; Intercompany Obligations

REG–107592–00; REG–105964–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and withdrawal of proposed regulations.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of transactions involving obligations between members of a consolidated group and the treatment of transactions involving the provision of insurance between members of a consolidated group. The regulations will affect corporations filing consolidated returns.

DATES: Written or electronic comments and requests for a public hearing must be received by December 27, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–107592–00), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–107592–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–107592–00).

FOR FURTHER INFORMATION CONTACT: Concerning submissions of comments and/or requests for a public hearing, Kelly Banks (202) 622–7180; concerning the proposed regulations, Frances L. Kelly (202) 622–7770 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On July 18, 1995, final regulations (T.D. 8597, 1995–2 C.B. 147) under §1.1502–13 were published in the **Federal Register** [60 FR 36671], amending the intercompany transaction system of the consolidated return regulations. These final regulations included rules under §1.1502–13(e) governing the treatment of insurance transactions between members of a consolidated group and rules under §1.1502–13(g) governing the treatment of obligations between members of a consolidated group (the Current Regulations).

On December 21, 1998, a notice of proposed rulemaking (REG–105964–98, 1999–1 C.B. 810) was published in the **Federal Register** [63 FR 70354], which proposed amendments to the intercompany obligation rules of §1.1502–13(g) (the 1998 Proposed Regulations). After consideration of comments received regarding the Current Regulations and the 1998 Proposed Regulations, the IRS and the Treasury Department believe that the rules governing the treatment of intercompany obligations need to be revised. Accordingly, the IRS and the Treasury Department are withdrawing the 1998 Proposed Regulations and issuing these new proposed regulations in their place. However, for purposes of determining the tax treatment of transactions undertaken prior to the finalization of these proposed regulations, taxpayers may continue to rely upon the form and timing of the recast transaction, as clarified by the 1998 Proposed Regulations.

In addition, the IRS and the Treasury Department propose to revise certain of the rules under §1.1502–13(e) that apply to intercompany transactions involving the provision of insurance between group members.

Explanation of Provisions

I. *Intercompany Obligation Regulations*

A. *General application*

Section 1.1502–13(g) prescribes rules relating to the treatment of transactions involving intercompany obligations. An intercompany obligation is generally defined as an obligation between members of a consolidated group, but only for the period during which both the creditor and debtor are members of the group.

Section 1.1502–13(g) can apply to three types of transactions: (1) transactions in which an obligation between a group member and a nonmember becomes an intercompany obligation, such as the purchase by a consolidated group member of another member's debt from a nonmember creditor or the acquisition by a consolidated group member of stock of a nonmember creditor or debtor (inbound transactions); (2) transactions in which an intercompany obligation ceases to be an intercompany obligation, such as the sale by a creditor member of another member's debt to a nonmember or the deconsolidation of either the debtor or creditor member (outbound transactions); and (3) transactions in which an intercompany obligation is assigned or extinguished within the consolidated group (intragroup transactions).

B. *The deemed satisfaction-reissuance model — Current Regulations and 1998 Proposed Regulations*

For all three types of transactions — inbound, outbound, and intragroup — the Current Regulations and the 1998 Proposed Regulations generally provide that an obligation is treated as satisfied and, if the obligation remains outstanding, reissued as a new obligation (the deemed satisfaction-reissuance model). These regulations are intended to minimize the effects of intercompany obligations on a consolidated group's taxable income.

For inbound transactions, the deemed satisfaction-reissuance model mirrors the mechanics and single-entity policies underlying the section 108(e)(4) regulations. However, in contrast to those regulations,

the deemed satisfaction-reissuance model also applies to obligations acquired for a premium and governs the treatment of the creditor as well as the debtor.

For outbound transactions, the deemed satisfaction-reissuance model furthers single-entity treatment by treating a consolidated group as a single issuer, and an intercompany obligation acquired or assumed by a nonmember as newly-issued debt. Thus, if a nonmember purchases an intercompany obligation at a discount, the nonmember will be treated as having acquired a new instrument with original issue discount to which section 1272 applies rather than market discount to which sections 1276 through 1278 apply.

For all three types of transactions, the deemed satisfaction-reissuance model preserves the location of a creditor and debtor member's items from an intercompany obligation, matches the timing of such items, and ensures that future items of original issue discount or premium between the creditor and debtor will similarly correspond in amount and timing.

Since the issuance of the 1998 Proposed Regulations, the IRS and the Treasury Department have considered whether, with respect to intragroup transactions, the objectives of §1.1502–13(g) could be better accomplished without a deemed satisfaction-reissuance model, and could instead be achieved solely through the matching and acceleration principles of §1.1502–13. After considering this approach, it was determined that special rules (in addition to the matching rule of §1.1502–13(c) and the acceleration rule of §1.1502–13(d)) would be necessary to ensure that transactions involving intercompany obligations clearly reflect consolidated taxable income. For example, if an intercompany obligation is sold to another member, the special rules and elections of the various debt regimes (that is, the rules for original issue discount, market discount, and acquisition premium) would have to be reconciled with the intercompany transaction rules through coordinating adjustments among the selling creditor, debtor, buying creditor, and any subsequent member creditors. The IRS and the Treasury Department have concluded that the deemed satisfaction-reissuance model is preferable to the complexity inherent in any such special rules.

Nonetheless, the IRS and the Treasury Department also have concluded that the deemed satisfaction-reissuance model can be improved in several respects. First, with respect to intragroup and outbound transactions, the mechanics of the model can be simplified and the amount for which an intercompany obligation is satisfied and reissued can be clarified. Second, the application of the model can be limited to those transactions for which its purposes are essential. Accordingly, these proposed regulations provide several exceptions to the application of the deemed satisfaction-reissuance model.

With respect to inbound transactions, the IRS and the Treasury Department have concluded that the mechanics of the deemed satisfaction-reissuance model and its application produce appropriate results and, therefore, no change has been proposed (except for the addition of a subgroup exception described in part I.H. of this preamble).

C. *Revised deemed satisfaction-reissuance model for intragroup and outbound transactions*

1. *Simplified mechanics*

Under the Current Regulations, and as revised under the 1998 Proposed Regulations, the mechanics of the deemed satisfaction and reissuance model are the same for both intragroup and outbound transactions. These mechanics generally treat an intercompany obligation as satisfied before an intragroup or outbound transaction and, if the obligation remains outstanding, reissued immediately after the transaction. Because these mechanics may affect the treatment of the actual transaction, they create uncertainties that have raised concerns among taxpayers.

To address these concerns, these proposed regulations adopt new and more precise mechanics for the application of the deemed satisfaction-reissuance model to certain intragroup and outbound transactions (or "triggering transactions" as described in part I.D. of this preamble). In general, the new model deems the following sequence of events to occur immediately before, and independently of, the actual transaction: (1) the debtor is deemed to satisfy the obligation for a cash amount equal to the obligation's fair market value; and (2) the debtor is deemed to immediately reissue the obligation to the original creditor for that same cash amount. The parties are then treated as engaging in the actual transaction but with the new obligation. For example, assume that S holds a B note with an adjusted issue price and basis of $100 and a fair market value of $70, and that S sells the B note to nonmember X for $70. Under the new deemed satisfaction-reissuance model, B is deemed, immediately before the sale to X, to satisfy the note for its fair market value of $70, resulting in $30 of cancellation of indebtedness income for B and $30 of loss for S (which is treated as ordinary loss under the attribute redetermination rule of §1.1502–13(c)(4)(i)). B is then treated as reissuing to S a new note with identical terms for $70 and S is treated as selling this new note to X.

By separating the deemed satisfaction and reissuance from the actual transaction in which the obligation is transferred, the new model avoids confusion regarding whether or how the deemed satisfaction proceeds are integrated with the actual transaction. The new model operates to trigger all built-in items arising from the obligation, and then reissue the obligation with an issue price equal to its basis (and generally, its fair market value) before the actual transaction. Thus, no further gain, loss, income, or deduction with respect to the obligation will result from the actual transaction. In the example above, because S has a basis in the new B note of $70, S recognizes no gain or loss in the actual sale of the note to X, and X acquires the new B note with original issue discount of $30. See section 1278(a)(2)(B) (coordination where bond has original issue discount). After the obligation is deemed satisfied and reissued, the occurrence of the actual transaction does not result in an additional deemed satisfaction and reissuance.

2. *The deemed satisfaction-reissuance amount*

The Current Regulations and the 1998 Proposed Regulations provide that the deemed satisfaction and reissuance amount generally should be determined using the original issue discount principles of sections 1273 and 1274. The IRS and the Treasury Department have

concluded, however, that for transactions where it is appropriate to require a deemed satisfaction and reissuance, the deemed satisfaction and reissuance amount generally should be equal to the obligation's fair market value.

The IRS and the Treasury Department acknowledge the inherent difficulty in valuing intercompany obligations. Nonetheless, the use of fair market value pricing more accurately preserves the location of a creditor and debtor member's items from an intercompany obligation and results in less distortion of the members' income, particularly where the issue price and value of the obligation differ significantly. Furthermore, in many transactions to which the deemed satisfaction-reissuance model applies under these proposed regulations, the group will often be required to determine the fair market value of the intercompany obligation because there is a taxable exchange of property for which the appropriate amount of gain or loss must be determined under general Internal Revenue Code (Code) principles. Accordingly, the IRS and the Treasury Department generally believe that requiring a deemed satisfaction and reissuance at fair market value will not be overly burdensome.

However, these proposed regulations also provide that where the creditor's amount realized with respect to the intercompany obligation in the transaction differs from the fair market value of the obligation, and the transaction is not an intragroup exchange of an intercompany obligation for a newly issued intercompany obligation, the deemed satisfaction and reissuance amount is the amount realized. For example, the amount realized with respect to an intercompany obligation may differ from fair market value if the creditor sells the obligation in a transaction to which section 1060 applies. In such cases, the use of amount realized rather than fair market value as the satisfaction amount for the deemed satisfaction and reissuance ensures that no additional items with respect to the obligation will result from the actual transaction.

If the transaction is an intragroup exchange of an intercompany obligation for a newly issued intercompany obligation, these proposed regulations provide that the obligation is deemed satisfied and reissued for its fair market value. In addition, for all such intragroup debt exchanges (other than routine intragroup debt modifications as discussed in part I.D.4 of this preamble), the newly issued obligation will be treated as having an issue price equal to its fair market value.

In addition, if a member's amount realized with respect to an intercompany obligation results from a mark to fair market value under section 475, then the obligation will be treated as satisfied and reissued under these regulations but will not otherwise be marked to fair market value under section 475 immediately thereafter. Because the deemed satisfaction and reissuance causes all built-in items from the obligation to be recognized, there is no need for an additional mark to fair market value under section 475. However, the rules of section 475 will continue to apply to the newly-reissued obligation with respect to future events.

These proposed regulations do not provide specific rules for intercompany obligations that are not debt instruments. The regulations generally provide that the principles applied to debt instruments will similarly apply (with appropriate adjustments) to such non-debt instruments. The IRS and the Treasury Department request comments on whether additional rules are needed for such instruments.

D. *Limitations on the application of the deemed satisfaction-reissuance model to intragroup transactions*

The Current Regulations and the 1998 Proposed Regulations apply the deemed satisfaction-reissuance model to intragroup transactions in which a member realizes an amount (under the Current Regulations, an amount of income, gain, deduction, or loss, other than zero) with respect to an intercompany obligation from the assignment or extinguishment of all or part of its remaining rights or obligations under the intercompany obligation (or from a comparable transaction).

These proposed regulations generally retain the deemed satisfaction-reissuance model for such intragroup transactions. Specifically, these proposed regulations apply the model upon a "triggering transaction," which is defined as any intercompany transaction in which a member realizes an amount, directly or indirectly, from the assignment or extinguishment of all or part of its remaining rights or obligations under an intercompany obligation (or from a comparable transaction). However, in recognition of the administrative burden involved in valuing intercompany obligations in certain transactions and in order to limit the effects of §1.1502–13(g) on certain routine intragroup transactions involving intercompany obligations (such as an intragroup merger of one member into another), these proposed regulations provide a number of exceptions from the application of the deemed satisfaction and reissuance model (subject to the material tax benefit rule described in part I.E. of this preamble).

In general, and as further described in this preamble, the IRS and the Treasury Department have sought to apply the deemed satisfaction-reissuance model only to those intragroup transactions that have the greatest potential to create distortions of consolidated taxable income and to exclude those transactions where the administrative burdens of either requiring precise valuation of intercompany obligations or requiring the additional mechanics of the deemed satisfaction-reissuance model outweigh the benefits of increased precision. The IRS and the Treasury Department request comments as to whether some or all of these exceptions are appropriate, as well as suggestions for other exceptions.

1. *Intragroup sections 332, 351, and 361 exchanges*

Under these proposed regulations, and subject to the material tax benefit rule as described in part I.E. of this preamble, assignments of intercompany obligations in certain intragroup nonrecognition transactions are excepted from the application of the deemed satisfaction-reissuance model. These transactions include transfers and assumptions of intercompany obligations in intragroup exchanges to which section 332 or section 361 apply if neither the creditor nor the debtor recognizes an amount of income, gain, deduction, or loss in the transaction, or in intragroup exchanges to which section 351 applies if no such amount is recognized by the creditor.

2. *Intragroup taxable assumption transactions*

These proposed regulations also provide an exception to the application of the deemed satisfaction-reissuance model for taxable intragroup sales of assets where intercompany obligations are assumed as part of the transaction. Where indebtedness is assumed incident to a sale of assets, in most cases, the location of gain or loss from an intercompany obligation is appropriately reflected in increased or reduced sales proceeds for the assets. Such transactions generally present less potential for distortion of consolidated taxable income. Accordingly, subject to the material tax benefit rule as described in part I.E. of this preamble, the regulations do not require a deemed satisfaction and reissuance where an intercompany obligation is assumed in a taxable intragroup sale of assets.

3. *Intragroup extinguishments — in general*

These proposed regulations except from the application of the deemed-satisfaction reissuance model many intragroup transactions in which an intercompany obligation is extinguished. In general, where an intercompany obligation is extinguished, the Code and regulations will cause the creditor and debtor to recognize their respective items from the obligation, and thus, preserve the location of such items. In such cases, a deemed satisfaction-reissuance model is not necessary. Thus, under these proposed regulations and subject to the material tax benefit rule as described in part I.E. of this preamble, the deemed satisfaction-reissuance model does not apply where the adjusted issue price of the obligation is equal to the creditor's basis in the obligation and the creditor's and debtor's items from the extinguishment transaction offset in amount.

These proposed regulations provide that certain Code provisions, such as section 108(a) and section 354 are inapplicable to gains and losses from intercompany obligations (and clarify that section 355(a)(1) is also inapplicable to such gains and losses). Turning off these provisions ensures single entity treatment by correcting mismatches that occur under the Code (where, for instance, a debtor has discharge of indebtedness income from the retirement of a security but the creditor's corresponding loss is not recognized) and requiring immediate recognition of both the debtor's and the creditor's items. The Current Regulations and the 1998 Proposed Regulations also provide that these Code provisions are inapplicable in many circumstances.

In the context of extinguishment transactions, the "turn-off" rule in these proposed regulations is applied first to determine whether the transaction is a triggering transaction. Because the rule imposes symmetrical treatment of the debtor and the creditor and requires that each member recognize their respective items, in many cases, the debtor's and creditor's items will offset in amount and the exception described above will apply. For example, assume a note with an adjusted issue price and basis of $100 is extinguished in a fully taxable transaction for $20 and that the debtor's cancellation of indebtedness income would otherwise be excluded under section 108(a). Because the turn-off rule makes section 108(a) inapplicable, the creditor's $80 loss and the debtor's $80 of cancellation of indebtedness income will offset in amount and the extinguishment transaction will not be subject to the deemed satisfaction and reissuance model.

However, the deemed satisfaction-reissuance model will continue to apply in those cases where, after taking into account the above-described "turn-off" rule, the creditor's and debtor's items from the transaction do not offset in amount. In these cases, depending upon the circumstances, the net amount of income, gain, loss, or deduction from the intercompany obligation may or may not be redetermined, under the principles of §1.1502–13(c)(1), to be excluded from gross income or treated as a noncapital, nondeductible amount.

4. *Routine intragroup modifications of intercompany obligations*

In general, the exchange of intercompany debt for newly issued intercompany debt presents a high potential for distortion of consolidated taxable income. Accordingly, these proposed regulations apply the deemed satisfaction-reissuance model at fair market value to such intragroup exchanges and generally provide that the newly issued obligation will be treated as issued for its fair market value. However, in order to avoid requiring valuation of intercompany obligations in routine debt modifications, the proposed regulations provide an exception for certain debt-for-debt exchanges involving a single issuer, subject to the material tax benefit rule as described in part I.E. of this preamble. Thus, if a member's intercompany debt is extinguished in exchange (or deemed exchange) for the member's newly issued intercompany debt, and the issue price of the new debt is equal to both the adjusted issue price and basis of the extinguished debt, the deemed satisfaction-reissuance model does not apply (and the newly issued debt is not treated as issued for its fair market value).

5. *Other exceptions for intragroup transactions*

These proposed regulations retain the exceptions in the Current Regulations for transactions involving an obligation that became an intercompany obligation by reason of an event described in §1.108–2(e), and for amounts realized from reserve accounting under section 585. However, consistent with the 1998 Proposed Regulations, these proposed regulations do not include the exception in the Current Regulations for transactions in which the deemed satisfaction and reissuance will not have a significant effect on any person's Federal income tax liability for any year.

E. *Material tax benefit rule*

Although these proposed regulations provide exceptions to the deemed satisfaction-reissuance model, the IRS and the Treasury Department remain concerned that the shifting of built-in items from intercompany obligations can give rise to significant potential for distortion. Intercompany obligations present special concerns because debt between members never increases or diminishes the wealth of the group (one member's economic gain is matched by the other's economic loss) and because, in comparison to other types of property, they can be easily created, transferred, modified, and extinguished within the group at little or no economic cost.

Therefore, in order to prevent distortions that may result from the shifting of built-in items from intercompany obligations, these proposed regulations include a special rule (the material tax benefit rule) that applies to intragroup transactions otherwise excepted from the deemed satisfaction-reissuance model under the exceptions for certain intragroup nonrecognition exchanges, taxable assumption transactions, extinguishment transactions, and routine debt modifications as described in parts I.D.1, 2, 3 and 4 of this preamble. The rule is directed at intragroup transactions that would have a distortive effect on members' attributes or the basis of member stock using built-in items from intercompany obligations.

The material tax benefit rule generally applies to an intragroup assignment or extinguishment that would otherwise be excepted from the deemed satisfaction-reissuance model if, at the time of the transaction, it is reasonably foreseeable (regardless of intent) that the shifting of items of built-in gain, loss, income, or deduction from an intercompany obligation between members will secure a material tax benefit that would not otherwise be enjoyed. In such cases, the intercompany transaction will be treated as a "triggering transaction" and will be subject to the deemed satisfaction-reissuance model as described in part I.C. of this preamble.

F. *Off-market issuance rule*

The IRS and the Treasury Department also believe that inappropriate distortions of consolidated taxable income could result from intercompany obligations that are issued at a materially off-market rate of interest. Such lending transactions may create built-in gain or loss in a newly issued obligation that could facilitate the manipulation of a member's attributes or the basis of member stock. Although off-market lending transactions are subject to various limitations under the Code and regulations (for example, sections 482, 1274, and 7872), the IRS and the Treasury Department believe that an additional rule is necessary to properly reflect consolidated taxable income.

Accordingly, these proposed regulations include a special rule (the off-market issuance rule) that generally applies if an intercompany obligation is issued at a rate of interest that is materially off-market, and at the time of issuance, it is reasonably foreseeable that the shifting of built-in items from the obligation from one member to another member will secure a material tax benefit. In such cases, the intercompany obligation will be treated as originally issued for its fair market value, and any difference between the amount loaned and the fair market value of the obligation will be treated as transferred between the creditor member and the debtor member at the time of issuance (for example, as a distribution or a contribution to capital). This rule is not intended to apply to intragroup lending at interest rates that approximate those that would have been charged in an arm's length transaction.

The IRS and the Treasury Department are continuing to explore the relationship between the intragroup off-market issuance rule and the other limitations imposed by the Code and regulations on such lending transactions, and request comments in this regard.

G. *Outbound transactions*

These proposed regulations have retained the deemed satisfaction-reissuance model (with the aforementioned new mechanics) for outbound transactions, as well as the exception in the Current Regulations for outbound transactions involving an obligation that became intercompany obligation in an event described in §1.108–2(e). These proposed regulations also include two additional exceptions applicable to outbound transactions.

The first, the subgroup exception, provides that the deemed satisfaction and reissuance model will not apply if the creditor and debtor to an intercompany obligation cease to be members of a consolidated group in a transaction in which neither member otherwise recognize an item with respect to the intercompany obligation, and immediately after the transaction, such creditor and debtor are members of another consolidated group. In such cases, a deemed satisfaction and reissuance is unnecessary because any built-in items with respect to the obligation will be appropriately preserved and offset in the new consolidated group. However, to minimize distortions in the new group that may result from these built-in items (for example, if S and B are acquired in different chains), the exception requires that the creditor and the debtor bear a relationship described in section 1504(a)(1) to each other through an intercompany obligation subgroup parent (which may be the debtor or the creditor).

These proposed regulations provide a second exception for an intercompany obligation that is newly issued in an intragroup reorganization and pursuant to the plan of reorganization, is distributed to a nonmember shareholder or creditor in a transaction to which section 361(c) applies. Because the obligation is newly issued in the reorganization and is distributed outside of the group as part of the same plan, the IRS and the Treasury Department believe that a deemed satisfaction and reissuance of the obligation is not necessary to carry out the purposes of §1.1502–13.

These proposed regulations also provide a rule that prevents indirect acceleration of a loss from an intercompany obligation through the sale of the obligation to a nonmember in exchange for a newly-issued obligation (the issue price of which is determined under section 1273(b)(4) or section 1274(a)) followed by a sale of the nonmember obligation at a loss. The regulations under section 108(e)(4) contain a similar rule.

H. *Inbound transactions*

Both the Current Regulations and the 1998 Proposed Regulations apply a deemed satisfaction-reissuance model for transactions in which a nonintercompany obligation becomes an intercompany obligation. For such transactions, the obligation is treated as satisfied and reissued immediately after it becomes an intercompany obligation.

These proposed regulations retain the deemed satisfaction-reissuance model for inbound transactions, but also include a "subgroup" exception for certain of these transactions. The subgroup exception for inbound transactions is similar to the subgroup exception for outbound transactions as described in part I.G. of this preamble.

In addition, these proposed regulations provide a special rule to prevent inappropriate acceleration of a deduction for repurchase premium in certain inbound transactions. A single corporation that repurchases its own debt in exchange for

a newly-issued debt, the issue price of which is determined under either section 1273(b)(4) or section 1274, must amortize any repurchase premium over the term of the newly-issued debt instrument. See §1.163–7(c). Because the IRS and the Treasury Department believe that it would be inconsistent with single-entity principles to permit consolidated groups an immediate deduction in similar circumstances, these proposed regulations provide that if indebtedness of a member is acquired in exchange for the issuance of indebtedness to a nonmember and the issue price of the newly-issued indebtedness is not determined by reference to its fair market value (for example, the issue price is determined under section 1273(b)(4) or section 1274(a)), then the repurchase premium from the deemed satisfaction will be amortized over the term of the obligation issued to the nonmember.

I. *Other request for comments*

In general, these proposed regulations retain the definition of intercompany obligation found in the Current Regulations and the 1998 Proposed Regulations. This definition excludes executory obligations to purchase or provide goods or services. The IRS and the Treasury Department are considering whether this exclusion is appropriate in all instances, and request comments in this regard.

As described in part I.G. of this preamble, these proposed regulations except from the deemed satisfaction-reissuance model outbound transfers of intercompany obligations where the obligation is newly issued in an intragroup reorganization and is then distributed to a nonmember shareholder or creditor in a transaction to which section 361(c) applies. These proposed regulations do not provide an exception for such transactions where the newly issued obligation is distributed within the group to a member shareholder or creditor. The IRS and the Treasury Department are studying the effects of the deemed satisfaction-reissuance model on such intragroup distributions and are considering various approaches to ensure the appropriate single-entity treatment of such transactions. Comments are requested in this regard.

These proposed regulations do not provide special rules for the treatment of intercompany obligations transferred or assumed in transactions under section 338. The IRS and the Treasury Department request comments in this regard.

The application of the deemed satisfaction-reissuance model and the matching principles of §1.1502–13(c) generally align the basis and issue price (or adjusted issue price) of an intercompany obligation and, thus, reduce potential distortions. For newly issued obligations, however, in certain circumstances the Code and regulations produce disparities between issue price and basis (such as the issuance of note by a subsidiary to its parent in a distribution to which section 301 applies). The IRS and the Treasury Department are considering whether it would be beneficial to eliminate any such disparity created upon the issuance of an obligation (for example, by treating such obligations as issued for fair market value) and request comments in this regard.

II. *Intercompany Insurance Regulations*

A. *Current regulations*

Under the Current Regulations, a member's special status as an insurance company is respected and, in some circumstances, results in an exception to the general single entity treatment for intercompany transactions. Under §1.1502–13(e)(2)(ii)(A), if a member provides insurance to another member in an intercompany transaction, the transaction is taken into account on a separate entity basis. Thus, premiums, reserve increases and decreases, and other similar items are determined and taken into account under the members' separate entity method of accounting rather than under the matching rule of §1.1502–13(c) and the acceleration rule of §1.1502–13(d). It was believed that such transactions would not have a substantial effect on consolidated taxable income, and therefore, it was appropriate to except these transactions from single entity treatment. This exception was intended to avoid the complexity that would result from adjustments needed to produce single entity results, and, thus, simplify intercompany accounting. See CO–11–91, 1994–1 C.B. 724 [59 FR 18011]. However, except with respect to the amount of any reserve item listed in section 807(c) or section 832(b)(5) resulting from an intercompany reinsurance transaction, this departure from single entity treatment does not extend to intercompany reinsurance transactions. See §1.1502–13(e)(2)(ii)(B).

Subsequent to the issuance of the Current Regulations, the IRS determined that it would no longer invoke the "economic family theory" in addressing whether captive insurance transactions constituted insurance for federal income tax purposes. Rev. Rul. 2001–31, 2001–1 C.B. 1348, (See §601.601(d)(2)(ii)(*b*).) In addition, the IRS and the Treasury Department have become aware of the increasing prevalence of captive insurance arrangements within consolidated groups. Thus, the separate entity treatment of insurance payments from one member of a group to a captive insurance member may now have a greater effect on consolidated taxable income than was anticipated when the Current Regulations were issued.

B. *Single entity treatment for significant insurance members*

The IRS and the Treasury Department believe that separate entity treatment for direct insurance transactions is inappropriate where a significant amount of the insuring member's business arises from transactions with other group members. Accordingly, these proposed regulations provide that, where a significant portion (5 percent or more) of the business of the insuring member (in such case, a "significant insurance member") arises from insuring the risks of other members (either by issuing insurance contracts directly to members or by reinsuring risks on contracts issued to members), it is appropriate to take into account the items from the intercompany transactions on a single entity basis. In such cases, the treatment of the members' items from the insurance transactions are subject to the matching and acceleration rules of §1.1502–13.

Under these rules, the insured member's deduction and the significant insurance member's income from the transaction will generally be taken into account currently. However, the effects of the intercompany transaction will otherwise be treated in a manner comparable to "self-insurance" by a single corporation. For example, the significant insurance member's discounted unpaid losses under section 832(b)(5) will be determined with-

out regard to the intercompany insurance transaction, and such member will instead take deductions with respect to losses incurred on intercompany insurance under the principles of sections 162 and 461. On the other hand, if a significant insurance member assumes all or a portion of the risk on an insurance contract written by another member with respect to risks of a nonmember, then under single entity principles, these proposed regulations generally permit the significant insurance member to increase its reserve item under section 807(c) or 832(b)(5) with respect to the premium payment.

These proposed regulations continue to except intercompany insurance transactions from single entity treatment where intercompany insurance represents less than 5 percent of the insuring member's business.

Reinsurance transactions engaged in by group members that attempt to circumvent the single entity rules of §1.1502–13(e) may be subject to the anti-avoidance rules of §1.1502–13(h). Thus, for example, if a member enters into an insurance contract with a third-party insurer and the contract is then reinsured with a member of the group in order to avoid treatment as an intercompany transaction, appropriate adjustments will be made to carry out the purposes of the intercompany transaction regulations. See also section 845, which allows the Secretary to allocate, recharacterize, or make other adjustments with respect to two or more related persons who are parties to a reinsurance agreement in order to reflect the proper amount, source, or character of taxable income related to such an agreement, or to make proper adjustments with respect to a party to a reinsurance contract if the contract has a significant tax avoidance effect.

C. *Request for comments*

The determination of whether an insuring member is a "significant insurance member" and, therefore, is subject to the special rules described above, is made on an annual basis by comparing the amount of the insuring member's business that arises from insuring the risks of other members with its total insurance business. In making this determination, these proposed regulations use an amount determined under section 832(b)(4)(A) (gross premiums written during the taxable year less return premiums and premiums paid for reinsurance) to measure the insuring member's annual insurance business. The IRS and the Treasury Department request comments as to whether this is an appropriate measure of an insuring member's business, as well as suggestions for alternatives. The IRS and the Treasury Department are also considering whether the status of an insuring member as a "significant insurance member" should be an annual determination and whether additional rules are needed when an insuring member's status changes. The IRS and the Treasury Department request comments in this regard, in addition to whether any additional special rules are needed to accomplish single entity treatment for intercompany insurance transactions.

Proposed Effective/Applicability Date and Reliance

These proposed regulations under §1.1502–13(g) apply to transactions involving intercompany obligations occurring in consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**. However, for purposes of determining the tax treatment of transactions undertaken prior to the finalization of these proposed regulations, taxpayers may continue to rely upon the form and timing of the recast transaction, as clarified by the 1998 Proposed Regulations (REG–105964–98) [63 FR 70354].

These proposed regulations under §1.1502–13(e) apply to intercompany transactions involving the provision of insurance occurring in consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Frances L. Kelly, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

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Withdrawal of Proposed Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–105964–98) that was published in the **Federal Register** on Monday, December 21, 1998, [63 FR 70354] is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding the following entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–13 also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502–13 is amended by:

1. Revising the fifth paragraph heading, each entry for Examples 1 through 5, and adding new Examples 6 through 11 in the table of examples in paragraph (a)(6)(ii).

2. Revising the first sentence of paragraph (e)(2)(i).

3. Adding new paragraph (e)(2)(ii)(C).

4. Revising paragraph (g).

5. Removing paragraph (j)(9) *Example 5(c)*.

The addition and revisions read as follows:

§1.1502–13 Intercompany transactions.

(a) * * *

(6) * * *

(ii) * * *

* * * * *

Obligations of members. (§1.1502–13(g)(7)(ii))

Example 1. Interest on intercompany obligation.

Example 2. Intercompany obligation becomes nonintercompany obligation.

Example 3. Loss or bad debt deduction with respect to intercompany obligation.

Example 4. Intercompany nonrecognition transactions.

Example 5. Assumption of intercompany obligation.

Example 6. Extinguishment of intercompany obligation.

Example 7. Exchange of intercompany obligations.

Example 8. Material tax benefit rule.

Example 9. Issuance at off-market rate of interest.

Example 10. Nonintercompany obligation becomes intercompany obligation.

Example 11. Notional principal contracts.

* * * * *

(e) * * *

(2) * * * (i) * * * Except as provided in paragraph (g)(4)(v) of this section (deferral of items from an intercompany obligation), a member's addition to, or reduction of, a reserve for bad debts that is maintained under section 585 is taken into account on a separate entity basis. * * *

(ii) * * *

(C) *Significant insurance member—(1) Single entity treatment for direct insurance and reinsurance.* If a significant insurance member (as defined in paragraph (e)(2)(ii)(C)(*2*)(*i*) of this section) insures the risk of another member (the insured member) in an intercompany transaction, paragraphs (e)(2)(ii)(A) and (B) of this section do not apply and the intercompany transaction is taken into account by both members on a single entity basis. For example, the timing and attributes of items from a premium payment from an insured member to a significant insurance member will be taken into account under the matching and acceleration rules, and the premiums earned with respect to the intercompany payment will not be accounted for by the significant insurance member under the rules of section 832(b)(4). The significant insurance member's deduction for losses incurred with respect to the intercompany insurance will be taken into account under the rules of sections 162 and 461 (including §1.461–2), rather than section 832(b)(5). However, under single-entity principles, if a significant insurance member assumes all or a portion of the risk on an insurance contract written by another member with respect to risks of a nonmember, then the matching and acceleration rules will generally permit the significant insurance member to increase its reserve item under section 807(c) or 832(b)(5) with respect to the premium payment.

(*2*) *Definitions.* For purposes of this paragraph (e)(2)(ii)(C), the following definitions apply:

(*i*) *Significant insurance member.* A member is a significant insurance member if it is an insurance company subject to tax under subchapter L and five percent or more of the member's insurance premiums written during the taxable year arise from insuring risks of other members of the group.

(*ii*) *Insurance premiums written during the taxable year* means gross premiums written (as defined in §1.832–4(a)(4) and as reported by the insuring member under the method prescribed by §1.832–4(a)(5)) on insurance contracts during the taxable year, less return premiums (as defined in §1.832–4(a)(6)) and premiums paid for reinsurance.

(*3*) *Effective/applicability date.* The rules of this paragraph (e)(2)(ii)(C) apply to intercompany transactions involving the provision of insurance occurring in consolidated return years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

(g) *Obligations of members*—(1) *In general.* In addition to the general rules of this section, the rules of this paragraph (g) apply to intercompany obligations.

(2) *Definitions.* For purposes of this section, the following definitions apply:

(i) *Obligation of a member* is a debt or security of a member.

(A) *Debt of a member* is any obligation of the member constituting indebtedness under general principles of Federal income tax law (for example, under nonstatutory authorities, or under section 108, section 163, or §1.1275–1(d)), but not an executory obligation to purchase or provide goods or services.

(B) *Security of a member* is any security of the member described in section 475(c)(2)(D) or (E), and any commodity of the member described in section 475(e)(2)(A), (B), or (C), but not if the security or commodity is a position with respect to the member's stock. See paragraphs (f)(4) and (f)(6) of this section for special rules applicable to positions with respect to a member's stock.

(ii) *Intercompany obligation* is an obligation between members, but only for the period during which both parties are members.

(iii) *Intercompany obligation subgroup* is comprised of two or more members that include the creditor and debtor on an intercompany obligation if the creditor and debtor bear the relationship described in section 1504(a)(1) to each other through an intercompany obligation subgroup parent.

(iv) *Intercompany obligation subgroup parent* is the corporation (including either the creditor or debtor) that bears the same relationship to the other members of the intercompany obligation subgroup as a common parent bears to the members of a consolidated group. Any reference to an intercompany obligation subgroup parent includes, as the context may require, a ref-

erence to a predecessor or successor. For this purpose, a predecessor is a transferor of assets to a transferee (the successor) in a transaction to which section 381(a) applies.

(v) *Material tax benefit* is the benefit of a material net reduction in income or gain, or a material net increase in loss, deduction, credit, or allowance. A material tax benefit includes, but is not limited to, the use of a built-in item or items from an intercompany obligation to materially reduce gain or increase loss on the sale of member stock, or to create or absorb a material tax attribute of a member or subgroup.

(3) *Deemed satisfaction and reissuance of intercompany obligations in triggering transactions*—(i) *Scope*—(A) *Triggering transactions.* For purposes of this paragraph (g)(3), a triggering transaction includes the following:

(*1*) *Assignment and extinguishment transactions.* Any intercompany transaction in which a member realizes an amount, directly or indirectly, from the assignment or extinguishment of all or part of its remaining rights or obligations under an intercompany obligation or any comparable transaction in which a member realizes any such amount, directly or indirectly, from an intercompany obligation (for example, a mark to fair market value of an obligation or a bad debt deduction). However, a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and §1.1502–28 (basis reductions upon the exclusion from gross income of discharge of indebtedness) or any other provision that adjusts the basis of an intercompany obligation as a substitute for income, gain, deduction, or loss, is not a comparable transaction.

(*2*) *Outbound transactions.* Any transaction in which an intercompany obligation becomes an obligation that is not an intercompany obligation.

(B) *Exceptions.* Except as provided in paragraph (g)(3)(i)(C) of this section, a transaction is not a triggering transaction as described in paragraph (g)(3)(i)(A) of this section if any of the exceptions in this paragraph (g)(3)(i)(B) apply. In making this determination, if a creditor or debtor realizes an amount in a transaction in which a creditor assigns all or part of its rights under an intercompany obligation to the debtor, or a debtor assigns all of or part of its obligations under an intercompany obligation to the creditor, the transaction will be treated as an extinguishment and will be excepted from the definition of "triggering transaction" only if either of the exceptions in paragraphs (g)(3)(i)(B)(*5*) or (*6*) of this section apply.

(*1*) *Intragroup section 332, 351, or 361 exchange.* The transaction is an intercompany exchange to which section 332 or section 361 applies in which no amount of income, gain, deduction or loss is recognized by the creditor or debtor, or an intercompany exchange to which section 351 applies in which no such amount is recognized by the creditor (unless section 362(e)(2) applies to the exchange).

(*2*) *Intragroup assumption transaction.* All of the debtor's obligations under an intercompany obligation are assumed in connection with the debtor's sale or other disposition of property (other than money) in an intercompany transaction to which section 1001 applies.

(*3*) *Exceptions to the application of section 108(e)(4).* The obligation became an intercompany obligation by reason of an event described in §1.108–2(e) (exceptions to the application of section 108(e)(4)).

(*4*) *Reserve accounting.* The amount realized is from reserve accounting under section 585 (see paragraph (g)(4)(v) of this section for special rules).

(*5*) *Intragroup extinguishment transaction.* All or part of the rights and obligations under the intercompany obligation are extinguished in an intercompany transaction (other than an exchange or deemed exchange of an intercompany obligation for a newly issued intercompany obligation), the adjusted issue price of the obligation is equal to the creditor's basis in the obligation, and the debtor's corresponding item and the creditor's intercompany item (after taking into account the special rules of paragraph (g)(4)(i)(C) of this section) with respect to the obligation offset in amount.

(*6*) *Routine modification of intercompany obligation.* All of the rights and obligations under the intercompany obligation are extinguished in an intercompany transaction that is an exchange (or deemed exchange) for a newly issued intercompany obligation, and the issue price of the newly issued obligation equals both the adjusted issue price of the extinguished obligation and the creditor's basis in the extinguished obligation.

(*7*) *Outbound distribution of newly issued intercompany obligation.* The intercompany obligation becomes an obligation that is not an intercompany obligation in a transaction in which a member that is a party to the reorganization exchanges property in pursuance of the plan of reorganization for a newly issued intercompany obligation of another member that is a party to the reorganization and distributes such intercompany obligation to a nonmember shareholder or nonmember creditor in a transaction to which section 361(c) applies.

(*8*) *Outbound subgroup exception.* The intercompany obligation becomes an obligation that is not an intercompany obligation in a transaction in which the members of an intercompany obligation subgroup cease to be members of a consolidated group, neither the creditor nor the debtor recognize any income, gain, deduction, or loss with respect to the intercompany obligation, and such members constitute an intercompany obligation subgroup of another consolidated group immediately after the transaction.

(C) *Material tax benefit rule.* If an assignment or extinguishment of an intercompany obligation in an intercompany transaction would otherwise be excepted from the definition of triggering transaction under paragraph (g)(3)(i)(B)(*1*), (*2*), (*5*), or (*6*) of this section, but at the time of the assignment or extinguishment, it is reasonably foreseeable that the shifting of items of built-in gain, loss, income, or deduction from the obligation from one member to another member will secure a material tax benefit (as defined in paragraph (g)(2)(v) of this section) that the group or its members would not otherwise enjoy in a consolidated or separate return year, then the assignment or extinguishment will be a triggering transaction to which paragraph (g)(3)(ii) of this section applies.

(ii) *Application of deemed satisfaction and reissuance.* This paragraph (g)(3)(ii) applies if a triggering transaction occurs.

(A) *General rule.* If the intercompany obligation is debt of a member, then (except as provided in the following sentence) the debt is treated for all Federal income tax purposes as having been satisfied by the debtor for cash in an amount equal to

its fair market value, and then as having been reissued as a new obligation (with a new holding period but otherwise identical terms) for the same amount of cash, immediately before the triggering transaction. However, if the creditor realizes an amount with respect to the debt in the triggering transaction that differs from the debt's fair market value, and the triggering transaction is not an exchange (or deemed exchange) of debt of a member for newly issued debt of a member, then the debt is treated for all Federal income tax purposes as having been satisfied by the debtor for cash in an amount equal to such amount realized, and reissued as a new obligation (with a new holding period but otherwise identical terms) for the same amount of cash, immediately before the triggering transaction. If the triggering transaction is a mark to fair market value under section 475, then the intercompany obligation will be deemed satisfied and reissued for its fair market value (as determined under section 475 and applicable regulations) and section 475 will not otherwise apply with respect to that triggering transaction. If the intercompany obligation is a security of a member, similar principles apply (with appropriate adjustments) to treat the security as having been satisfied and reissued immediately before the triggering transaction.

(B) *Treatment as separate transaction.* The deemed satisfaction and reissuance is treated as a separate transaction from the triggering transaction. The deemed satisfaction and reissuance of a member's debt will not cause the debt to be recharacterized as other than debt for Federal income tax purposes immediately before the triggering transaction.

(4) *Special rules*—(i) *Timing and attributes.* For purposes of applying the matching rule and the acceleration rule to a transaction involving an intercompany obligation (other than a transaction to which paragraph (g)(5) of this section applies)—

(A) Paragraph (c)(6)(i) of this section (treatment of intercompany items if corresponding items are excluded or nondeductible) will not apply to exclude any amount of income or gain attributable to a reduction of the basis of the intercompany obligation pursuant to sections 108 and 1017 and §1.1502–28, or any other provision that adjusts the basis of an intercompany obligation as a substitute for income or gain;

(B) Paragraph (c)(6)(ii) of this section (limitation on treatment of intercompany income or gain as excluded from gross income) does not apply to prevent any intercompany income or gain from the intercompany obligation from being excluded from gross income;

(C) Any income, gain, deduction, or loss from the intercompany obligation is not subject to section 108(a), section 354, section 355(a)(1), section 1091, or, in the case of an extinguishment of an intercompany obligation in a transaction in which the creditor transfers the obligation to the debtor in exchange for stock in such debtor, section 351(a); and

(D) Section 108(e)(7) does not apply upon the extinguishment of an intercompany obligation.

(ii) *Newly issued obligation in intragroup exchanges.* If an intercompany obligation is exchanged (or is deemed exchanged) for a newly issued intercompany obligation and the exchange (or deemed exchange) is not a routine modification of an intercompany obligation (as described in paragraph (g)(3)(i)(B)(*6*) of this section), then the newly issued obligation will be treated for all Federal income tax purposes as having an issue price equal to its fair market value.

(iii) *Off-market issuance.* If an intercompany obligation is issued at a rate of interest that is materially off-market (off-market obligation) and at the time of issuance, it is reasonably foreseeable that the shifting of items of built-in gain, loss, income, or deduction from the obligation from one member to another member will secure a material tax benefit (as defined in paragraph (g)(2)(v) of this section), then the intercompany obligation will be treated, for all Federal income tax purposes, as originally issued for its fair market value, and any difference between the amount loaned and the fair market value of the obligation will be treated as transferred between the creditor and the debtor at the time the obligation is issued. For example, if S lends $100 to B in return for an off-market B note with a value of $130, and at that time, it is reasonably foreseeable that a material tax benefit will be secured by the shifting of items from the note, then the B note will be treated as issued for $130. The $30 difference will be treated as a distribution or capital contribution between S and B (as appropriate) at the time of issuance, and this amount will be reflected in future payments on the note as bond issuance premium. An adjustment to an off-market obligation under this paragraph (g)(4)(iii) will be made without regard to the application of, and in lieu of any adjustment under, section 467 (certain payments for the use of property or services), 482 (allocations among commonly controlled taxpayers), 483 (interest on certain deferred payments), 1274 (determination of issue price for certain debt instruments issued for property), or 7872 (treatment of loans with below-market interest rates.

(iv) *Deferral of loss or deduction with respect to nonmember indebtedness acquired in certain debt exchanges.* If a creditor transfers an intercompany obligation to a nonmember (former intercompany obligation) in exchange for newly issued debt of a nonmember (nonmember debt), and the issue price of the nonmember debt is not determined by reference to its fair market value (for example, the issue price is determined under section 1273(b)(4) or 1274(a) or any other provision of applicable law), then any loss of the creditor otherwise allowable on the subsequent disposition of the nonmember debt, or any comparable tax benefit that would otherwise be available in any other transaction that directly or indirectly results from the disposition of the nonmember debt, is deferred until the date the debtor retires the former intercompany obligation.

(v) *Bad debt reserve.* A member's deduction under section 585 for an addition to its reserve for bad debts with respect to an intercompany obligation is not taken into account, and is not treated as realized for purposes of paragraph (g)(3)(i)(A)(*1*) of this section, until the intercompany obligation is extinguished or becomes an obligation that is not an intercompany obligation.

(5) *Deemed satisfaction and reissuance of obligations becoming intercompany obligations*—(i) *Application of deemed satisfaction and reissuance*—(A) *In general.* This paragraph (g)(5) applies if an obligation that is not an intercompany obligation becomes an intercompany obligation.

(B) *Exceptions.* This paragraph (g)(5) does not apply to an intercompany obliga-

tion if either of the following exceptions apply.

(*1*) *Exceptions to the application of section 108(e)(4).* The obligation becomes an intercompany obligation by reason of an event described in §1.108–2(e) (exceptions to the application of section 108(e)(4)); or

(*2*) *Inbound subgroup exception.* The obligation becomes an intercompany obligation in a transaction in which the members of an intercompany obligation subgroup cease to be members of a consolidated group, neither the creditor nor the debtor recognize any income, gain, deduction, or loss with respect to the intercompany obligation, and such members constitute an intercompany obligation subgroup of another consolidated group immediately after the transaction.

(ii) *Deemed satisfaction and reissuance*—(A) *General rule.* If the intercompany obligation is debt of a member, then the debt is treated for all Federal income tax purposes, immediately after it becomes an intercompany obligation, as having been satisfied by the debtor for cash in an amount determined under the principles of §1.108–2(f), and then as having been reissued as a new obligation (with a new holding period but otherwise identical terms) for the same amount of cash. If the intercompany obligation is a security of a member, similar principles apply (with appropriate adjustments) to treat the security, immediately after it becomes an intercompany obligation, as satisfied and reissued by the debtor for cash in an amount equal to its fair market value.

(B) *Treatment as separate transaction.* The deemed satisfaction and reissuance is treated as a separate transaction from the transaction in which the debt becomes an intercompany obligation, and the tax consequences of the transaction in which the debt becomes an intercompany obligation must be determined before the deemed satisfaction and reissuance occurs. (For example, if the debt becomes an intercompany obligation in a transaction to which section 351 applies, any limitation imposed by section 362(e) on the basis of the intercompany obligation in the hands of the transferee member is determined before the deemed satisfaction and reissuance.) The deemed satisfaction and reissuance of a member's debt will not cause the debt to be recharacterized as other than debt for Federal income tax purposes.

(6) *Special rules*—(i) *Timing and attributes.* If paragraph (g)(5) of this section applies to an intercompany obligation—

(A) Section 108(e)(4) does not apply;

(B) The attributes of all items taken into account from the satisfaction of the intercompany obligation are determined on a separate entity basis, rather than by treating S and B as divisions of a single corporation; and

(C) Any intercompany gain or loss realized by the creditor is not subject to section 354 or section 1091.

(ii) *Waiver of loss carryovers from separate return limitation years.* Solely for purposes of §1.1502–32(b)(4) and the effect of any election under that provision, any loss taken into account under paragraph (g)(5) of this section by a corporation that becomes a member as a result of the transaction in which the obligation becomes an intercompany obligation is treated as a loss carryover from a separate return limitation year.

(iii) *Deduction of repurchase premium in certain debt exchanges.* If an obligation to which paragraph (g)(5) of this section applies is acquired in exchange for the issuance of an obligation to a nonmember and the issue price of this newly issued obligation is not determined by reference to its fair market value (for example, the issue price is determined under section 1273(b)(4) or 1274(a) or any other provision of applicable law), then, under the principles of §1.163–7(c), any repurchase premium from the deemed satisfaction of the intercompany obligation under paragraph (g)(5)(ii) of this section will be amortized by the debtor over the term of the obligation issued to the nonmember in the same manner as if it were original issue discount and the obligation to the nonmember had been issued directly by the debtor.

(7) *Examples*—(i) *In general.* For purposes of the examples in this paragraph (g), unless otherwise stated, interest is qualified stated interest under §1.1273–1(c), and the intercompany obligations are capital assets and are not subject to section 475.

(ii) The application of this section to obligations of members is illustrated by the following examples:

Example 1. Interest on intercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. B fully performs its obligations. Under their separate entity methods of accounting, B accrues a $10 interest deduction annually under section 163, and S accrues $10 of interest income annually under section 61(a)(4) and §1.446–2.

(ii) *Matching rule.* Under paragraph (b)(1) of this section, the accrual of interest on B's note is an intercompany transaction. Under the matching rule, S takes its $10 of income into account in each of years 1 through 5 to reflect the $10 difference between B's $10 of interest expense taken into account and the $0 recomputed expense. S's income and B's deduction are ordinary items. (Because S's intercompany item and B's corresponding item would both be ordinary on a separate entity basis, the attributes are not redetermined under paragraph (c)(1)(i) of this section.)

(iii) *Original issue discount.* The facts are the same as in paragraph (i) of this *Example 1*, except that B borrows $90 (rather than $100) from S in return for B's note providing for $10 of interest annually and repayment of $100 at the end of year 5. The principles described in paragraph (ii) of this *Example 1* for stated interest also apply to the $10 of original issue discount. Thus, as B takes into account its corresponding expense under section 163(e), S takes into account its intercompany income under section 1272. S's income and B's deduction are ordinary items.

(iv) *Tax-exempt income.* The facts are the same as in paragraph (i) of this *Example 1*, except that B's borrowing from S is allocable under section 265 to B's purchase of state and local bonds to which section 103 applies. The timing of S's income is the same as in paragraph (ii) of this *Example 1*. Under paragraph (c)(4)(i) of this section, the attributes of B's corresponding item of disallowed interest expense control the attributes of S's offsetting intercompany interest income. Paragraph (c)(6) of this section does not prevent the redetermination of S's intercompany item as excluded from gross income because section 265(a)(2) permanently and explicitly disallows B's corresponding deduction and because, under paragraph (g)(4)(i)(B) of this section, paragraph (c)(6)(ii) of this section does not apply to prevent any intercompany income from the B note from being excluded from gross income. Accordingly, S's intercompany income is treated as excluded from gross income.

Example 2. Intercompany obligation becomes nonintercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has paid the interest accruing under the note and S sells B's note to X for $70, reflecting an increase in prevailing market interest rates. B is never insolvent within the meaning of section 108(d)(3).

(ii) *Deemed satisfaction and reissuance.* Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $70 immediately before S's sale to X. As a result of the deemed satisfaction of the note

for less than its adjusted issue price, B takes into account $30 of discharge of indebtedness income under §1.61–12. On a separate entity basis, S's $30 loss would be a capital loss under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's $30 of discharge of indebtedness income control the attributes of S's loss. Thus, S's loss is treated as ordinary loss. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis in the hands of S. S is then treated as selling the new note to X for the $70 received by S in the actual transaction. Because S has a basis of $70 in the new note, S recognizes no gain or loss from the sale to X. After the sale, the new note held by X is not an intercompany obligation, it has a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis. The $30 of original issue discount will be taken into account by B and X under sections 163(e) and 1272.

(iii) *Creditor deconsolidation.* The facts are the same as in paragraph (i) of this *Example 2*, except that P sells S's stock to X (rather than S selling B's note to X). Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its $70 fair market value immediately before S becomes a nonmember. The treatment of S's $30 of loss and B's $30 of discharge of indebtedness income is the same as in paragraph (ii) of this *Example 2*. The new note held by S upon deconsolidation is not an intercompany obligation, it has a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis. The $30 of original issue discount will be taken into account by B and S under sections 163(e) and 1272.

(iv) *Debtor deconsolidation.* The facts are the same as in paragraph (i) of this *Example 2*, except that P sells B's stock to X (rather than S selling B's note to X). The results to S and B are the same as in paragraph (iii) of this *Example 2*.

(v) *Subgroup exception.* The facts are the same as in paragraph (i) of this *Example 2*, except that P owns all of the stock of S, S owns all of the stock of B, and P sells all of the S stock to X, the parent of another consolidated group. Because B and S, members of an intercompany obligation subgroup, cease to be members of the P group in a transaction that does not cause either member to recognize an item with respect to the B note, and such members constitute an intercompany obligation subgroup in the X group, P's sale of S stock is not a triggering transaction under paragraph (g)(3)(i)(B)(*8*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. After the sale, the note held by S has a $100 issue price, a $100 stated redemption price at maturity, and a $100 basis. The results are the same if the S stock is sold to an individual and the S-B affiliated group elects to file a consolidated return for the period beginning on the day after S and B cease to be members of the P group.

(vi) *Section 338 election.* The facts are the same as paragraph (i) of this *Example 2*, except that P sells S's stock to X and a section 338 election is made with respect to the stock sale. Under section 338, S is treated as selling all of its assets to X, including the B note, at the close of the acquisition date. The aggregate deemed sales price (within the meaning of §1.338–4) allocated to the B note is $70. Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued immediately before S's deemed sale to X for $70, the amount realized with respect to the note (the aggregate deemed sales price allocated to the note under §1.338–6). The results to S and B are the same as in paragraph (ii) of this *Example 2*.

(vii) *Appreciated note.* The facts are the same as in paragraph (i) of this *Example 2*, except that S sells B's note to X for $130 (rather than $70), reflecting a decline in prevailing market interest rates. Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $130 immediately before S's sale to X. As a result of the deemed satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under §1.163–7(c). On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $130 issue price, $100 stated redemption price at maturity, and $130 basis in the hands of S. S is then treated as selling the new note to X for the $130 received by S in the actual transaction. Because S has a basis of $130 in the new note, S recognizes no gain or loss from the sale to X. After the sale, the new note held by X is not an intercompany obligation, it has a $130 issue price, a $100 stated redemption price at maturity, and a $130 basis. The treatment of B's $30 of bond issuance premium under the new note is determined under §1.163–13.

Example 3. Loss or bad debt deduction with respect to intercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. On January 1 of year 3, the fair market value of the B note has declined to $60 and S sells the B note to P for property with a fair market value of $60. B is never insolvent within the meaning of section 108(d)(3). The B note is not a security within the meaning of section 165(g)(2).

(ii) *Deemed satisfaction and reissuance.* Because S realizes an amount of loss from the assignment of the B note, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $60 immediately before S's sale to P. As a result of the deemed satisfaction of the note for less than its adjusted issue price ($100), B takes into account $40 of discharge of indebtedness income under §1.61–12. On a separate entity basis, S's $40 loss would be a capital loss under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's $40 of discharge of indebtedness income control the attributes of S's loss. Thus, S's loss is treated as ordinary loss. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $60 issue price, $100 stated redemption price at maturity, and $60 basis in the hands of S. S is then treated as selling the new note to P for the $60 of property received by S in the actual transaction. Because S has a basis of $60 in the new note, S recognizes no gain or loss from the sale to P. After the sale, the note is an intercompany obligation, it has a $60 issue price and a $100 stated redemption price at maturity, and the $40 of original issue discount will be taken into account by B and P under sections 163(e) and 1272.

(iii) *Partial bad debt deduction.* The facts are the same as in paragraph (i) of this *Example 3*, except that S claims a $40 partial bad debt deduction under section 166(a)(2) (rather than selling the note to P). Because S realizes a deduction from a transaction comparable to an assignment of the B note, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $60 immediately before section 166(a)(2) applies. The treatment of S's $40 loss and B's $40 of discharge of indebtedness income are the same as in paragraph (ii) of this *Example 3*. After the reissuance, S has a basis of $60 in the new note. Accordingly, the application of section 166(a)(2) does not result in any additional deduction for S. The $40 of original issue discount on the new note will be taken into account by B and S under sections 163(e) and 1272.

(iv) *Insolvent debtor.* The facts are the same as in paragraph (i) of this *Example 3*, except that B is insolvent within the meaning of section 108(d)(3) at the time that S sells the note to P. As explained in paragraph (ii) of this *Example 3*, the transaction is a triggering transaction and the B note is treated as satisfied and reissued for its fair market value of $60 immediately before S's sale to P. On a separate entity basis, S's $40 loss would be capital, B's $40 income would be excluded from gross income under section 108(a), and B would reduce attributes under section 108(b) or section 1017 (see also §1.1502–28). However, under paragraph (g)(4)(i)(C) of this section, section 108(a) does not apply to characterize B's income as excluded from gross income. Accordingly, the attributes of S's loss and B's income are redetermined in the same manner as in paragraph (ii) of this *Example 3*.

Example 4. Intercompany nonrecognition transactions. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $130, reflecting a de-

cline in prevailing market interest rates. On January 1 of year 3, S transfers the note and other assets to a newly formed corporation, Newco, for all of Newco's stock in an exchange to which section 351 applies. The aggregate adjusted bases of property transferred does not exceed the fair market value of such property immediately after the transfer.

(ii) *No deemed satisfaction and reissuance.* Because the assignment of the B note is an exchange to which section 351 applies and S recognizes no gain or loss, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*1*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

(iii) *Receipt of other property.* The facts are the same as in paragraph (i) of this *Example 4*, except that the other assets transferred to Newco have a basis of $100 and a fair market value of $260, and S receives, in addition to Newco stock, $15 of cash. Because S would recognize $15 of gain under section 351(b), the assignment of the B note is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $130 immediately before the transfer to Newco. As a result of the deemed satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under §1.163–7(c). On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $130 issue price, $100 stated redemption price at maturity, and $130 basis in the hands of S. S is then treated as transferring the new note to Newco for the Newco stock and cash received by S in the actual transaction. Because S has a basis of $130 in the new B note, S recognizes no gain or loss with respect to the transfer of the note in the section 351 exchange, and S recognizes $10 of gain with respect to the transfer of the other assets under section 351(b). After the transfer, the note has a $130 issue price and a $100 stated redemption price at maturity. The treatment of B's $30 of bond issuance premium under the new note is determined under §1.163–13.

(iv) *Intercompany obligation transferred in section 332 transaction.* The facts are the same as in paragraph (i) of this *Example 4*, except that S transfers the B note to P in complete liquidation under section 332. Because the transaction is an exchange to which section 332 applies, and neither S nor B recognize gain or loss, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*1*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

Example 5. Assumption of intercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. The note is fully recourse and is incurred for use in Business Z. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $110 reflecting a decline in prevailing market interest rates. Business Z has a fair market value of $95. On January 1 of year 3, B transfers all of the assets of Business Z and $15 of cash to M in exchange for the assumption by M of all of B's obligations under the note. The terms and conditions of the note are not modified in connection with the sales transaction, and no amount of income, gain, loss, or deduction is recognized by S, B, or M with respect to the note.

(ii) *No deemed satisfaction and reissuance.* Because all of B's obligations under the B note are assumed by M in connection with the sale of the Business Z assets, the assignment of B's obligations under the note is not a triggering transaction under paragraph (g)(3)(i)(B)(*2*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

Example 6. Extinguishment of intercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. The note is a security within the meaning of section 351(d)(2). As of January 1 of year 3, B has fully performed its obligations, but the fair market value of the B note is $130, reflecting a decline in prevailing market interest rates, and S transfers the note to B in exchange for $130 of B stock in a transaction to which section 351 applies.

(ii) *No deemed satisfaction and reissuance.* As a result of the satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under §1.163–7(c). Although the transfer of the B note is a transaction to which section 351 applies, under paragraph (g)(4)(i)(C) of this section, any gain or loss from the intercompany obligation is not subject to section 351(a), and therefore, S has a $30 gain under section 1001. Because the note is extinguished in a transaction in which the adjusted issue price of the note is equal to the creditor's basis in the note, and the debtor's and creditor's items offset in amount, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*5*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. Under paragraph (g)(4)(i)(D) of this section, section 108(e)(7) does not apply upon the extinguishment of the B note, and therefore, the B stock received by S in the exchange will not be treated as section 1245 property.

Example 7. Exchange of intercompany obligations. (i) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 20. As of January 1 of year 3, B has fully performed its obligations and, pursuant to a recapitalization to which section 368(a)(1)(E) applies, B issues a new note to S in exchange for the original B note. The new B note has an issue price, stated redemption price at maturity, and stated principal amount of $100, but contains terms that differ sufficiently from the terms of the original B note to cause a realization event under §1.1001–3. The original B note and the new B note are both securities (within the meaning of section 354(a)(1)).

(ii) *No deemed satisfaction and reissuance.* Because the original B note is extinguished in exchange for a newly issued B note and the issue price of the new B note is equal to both the adjusted issue price of the original B note and S's basis in the original B note, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*6*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. B has neither income from discharge of indebtedness under section 108(e)(10) nor a deduction for repurchase premium under §1.163–7(c). Although the exchange of the original B note for the new B note is a transaction to which section 354 applies, under paragraph (g)(4)(i)(C) of this section, any gain or loss from the intercompany obligation is not subject to section 354. Under section 1001, S has no gain or loss from the exchange of notes.

Example 8. Material tax benefit rule. (i) *Facts.* T is a member with a material loss from a separate return limitation year (SRLY). S holds a materially appreciated B note which it transfers to T as part of an exchange which otherwise qualifies for nonrecognition treatment under section 351.

(ii) *Deemed satisfaction and reissuance.* Under paragraph (g)(3)(i)(B)(*1*) of this section, absent the application of the material tax benefit rule of paragraph (g)(3)(i)(C) of this section, the assignment of the B note would not be a triggering transaction. However, because at the time of the assignment, it is reasonably foreseeable that the shifting of the built-in income or gain from the obligation will secure a material tax benefit that the group or its members would not otherwise enjoy, under paragraph (g)(3)(i)(C) of this section, the assignment of the B note is a triggering transaction to which paragraph (g)(3)(ii) of this section applies. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value, immediately before S's transfer to T. As a result of the deemed satisfaction of the note for more than its adjusted issue price, S takes into account gain and B has a corresponding repurchase premium deduction. B is also treated as reissuing, immediately after the deemed satisfaction, a new note to S with an issue price and basis equal to its fair market value. S is then treated as transferring the new note to T as part of the section 351 exchange. Because T will have a fair market value basis in the reissued B note immediately after the exchange, T's intercompany item from the subsequent retirement of the B note will not reflect any of S's built-in gain (and the amount of SRLY loss that may be absorbed by such item will be limited to any appreciation in the B note accruing after the exchange).

(iii) *No material tax benefit.* The facts are the same as in paragraph (i) of this *Example 8*, except that S has a SRLY loss that exceeds, and will expire prior to, that of T. Further, it is anticipated that S and T will each generate similar amounts of income for the foreseeable future, and there is no plan or intention to sell the stock of either member. Because the built-in income or gain from the B note could have been used to facilitate the absorption of S's SRLY loss (rather than

an equal amount of T's SRLY loss), the group and its members have not secured a material tax benefit from the assignment that it would not have otherwise enjoyed. Accordingly, the assignment is not subject to the material tax benefit rule of paragraph (g)(3)(i)(C) of this section, and the B note is not deemed satisfied and reissued under paragraph (g)(3)(ii) of this section.

Example 9. Issuance at off-market rate of interest. (i) *Facts.* T is a member with a material loss from a separate return limitation year (SRLY). T's sole shareholder, P, borrows an amount from T in return for a P note that provides for a materially above market rate of interest. As a result, the P note will generate additional interest income to T over the term of the note which will facilitate the absorption of T's SRLY loss each year and will result in a material tax benefit.

(ii) *Reasonably foreseeable.* Because at the time of the issuance, it is reasonably foreseeable that the shifting of interest income from the off-market obligation will secure a material tax benefit that the group or its members would not otherwise enjoy, under paragraph (g)(4)(iii) of this section, the intercompany obligation is treated, for all Federal income tax purposes, as originally issued for its fair market value so T is treated as purchasing the note at a premium. The difference between the amount loaned and the fair market value of the obligation is treated as transferred from P to T as a capital contribution at the time the note is issued. Throughout the term of the note, T takes into account interest income and bond premium and P takes into account interest deduction and bond issuance premium under generally applicable Internal Revenue Code sections. Because paragraph (g)(4)(iii) of this section applies, no adjustment is made under section 482.

Example 10. Nonintercompany obligation becomes intercompany obligation. (i) *Facts.* On January 1 of year 1, B borrows $100 from X in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $70, reflecting an increase in prevailing market interest rates. On January 1 of year 3, P buys all of X's stock. B is solvent within the meaning of section 108(d)(3).

(ii) *Deemed satisfaction and reissuance.* Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied for $70 (determined under the principles of §1.108–2(f)(2)) immediately after it becomes an intercompany obligation. Both X's $30 capital loss (under section 1271(a)(1)) and B's $30 of discharge of indebtedness income (under §1.61–12) are taken into account in determining consolidated taxable income for year 3. Under paragraph (g)(6)(i)(B) of this section, the attributes of items resulting from the satisfaction are determined on a separate entity basis. But see section 382 and §1.1502–15 (as appropriate). B is also treated as reissuing a new note to X. The new note is an intercompany obligation, it has a $70 issue price and $100 stated redemption price at maturity, and the $30 of original issue discount will be taken into account by B and X in the same manner as provided in paragraph (iii) of *Example 1* of this paragraph (g)(7).

(iii) *Amortization of repurchase premium.* The facts are the same as in paragraph (i) of this *Example 10*, except that on January 1 of year 3, the B note has a fair market value of $130 and rather than purchasing the X stock, S purchases the B note from X by issuing its own note. The S note has an issue price, stated redemption price at maturity, stated principal amount, and a fair market value of $130. Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied for $130 (determined under the principles of §1.108–2(f)(1)) immediately after it becomes an intercompany obligation. As a result of the deemed satisfaction of the note, S has no gain or loss and B has $30 of repurchase premium. Under paragraph (g)(6)(iii) of this section, B's $30 of repurchase premium from the deemed satisfaction is amortized by B over the term of the newly issued S note in the same manner as if it were original issue discount and the newly issued S note had been issued directly by B. B is also treated as reissuing a new note to S. The new note is an intercompany obligation, it has a $130 issue price and $100 stated redemption price at maturity, and the treatment of B's $30 of bond issuance premium under the new B note is determined under §1.163–13.

(iv) *Election to file consolidated returns.* Assume instead that B borrows $100 from S during year 1, but the P group does not file consolidated returns until year 3. Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied and reissued as a new note immediately after the note becomes an intercompany obligation. The satisfaction and reissuance are deemed to occur on January 1 of year 3, for the fair market value of the obligation (determined under the principles of §1.108–2(f)(2)) at that time.

Example 11. Notional principal contracts. (i) *Facts.* On April 1 of year 1, M1 enters into a contract with counterparty M2 under which, for a term of five years, M1 is obligated to make a payment to M2 each April 1, beginning in year 2, in an amount equal to the London Interbank Offered Rate (LIBOR), as determined by reference to LIBOR on the day each payment is due, multiplied by a $1,000 notional principal amount. M2 is obligated to make a payment to M1 each April 1, beginning in year 2, in an amount equal to 8 percent multiplied by the same notional principal amount. LIBOR is 7.80 percent on April 1 of year 2, and therefore, M2 owes $2 to M1.

(ii) *Matching rule.* Under §1.446–3(d), the net income (or net deduction) from a notional principal contract for a taxable year is included in (or deducted from) gross income. Under §1.446–3(e), the ratable daily portion of M2's obligation to M1 as of December 31 of year 1 is $1.50 ($2 multiplied by 275/365). Under the matching rule, M1's net income for year 1 of $1.50 is taken into account to reflect the difference between M2's net deduction of $1.50 taken into account and the $0 recomputed net deduction. Similarly, the $.50 balance of the $2 of net periodic payments made on April 1 of year 2 is taken into account for year 2 in M1's and M2's net income and net deduction from the contract. In addition, the attributes of M1's intercompany income and M2's corresponding deduction are redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of M2's corresponding deduction control the attributes of M1's intercompany income. (Although M1 is the selling member with respect to the payment on April 1 of year 2, it might be the buying member in a subsequent period if it owes the net payment.)

(iii) *Dealer.* The facts are the same as in paragraph (i) of this *Example 11*, except that M2 is a dealer in securities, and the contract with M1 is not inventory in the hands of M2. Under section 475, M2 must mark its securities to fair market value at year-end. Assume that under section 475, M2's loss from marking to fair market value the contract with M1 is $10. Because M2 realizes an amount of loss from the mark to fair market value of the contract, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, M2 is treated as making a $10 payment to M1 to terminate the contract immediately before a new contract is treated as reissued with an up-front payment by M1 to M2 of $10. M1's $10 of income from the termination payment is taken into account under the matching rule to reflect M2's deduction under §1.446–3(h). The attributes of M1's intercompany income and M2's corresponding deduction are redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of M2's corresponding deduction control the attributes of M1's intercompany income. Accordingly, M1's income is treated as ordinary income. Under §1.446–3(f), the deemed $10 up-front payment by M1 to M2 in connection with the issuance of a new contract is taken into account over the term of the new contract in a manner reflecting the economic substance of the contract (for example, allocating the payment in accordance with the forward rates of a series of cash-settled forward contracts that reflect the specified index and the $1,000 notional principal amount). (The timing of taking items into account is the same if M1, rather than M2, is the dealer subject to the mark-to-market requirement of section 475 at year-end. However in this case, because the attributes of the corresponding deduction control the attributes of the intercompany income, M1's income from the deemed termination payment from M2 might be ordinary or capital). Under paragraph (g)(3)(ii)(A) of this section, section 475 does not apply to mark the notional principal contract to fair market value after its deemed satisfaction and reissuance.

(8) *Effective/applicability date.* The rules of this paragraph (g) apply to transactions involving intercompany obligations occurring in consolidated return years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 28, 2007, 72 F.R. 55139)

IRS and the George Washington University Law School to Sponsor Institute on International Tax Issues

Announcement 2007–100

The Internal Revenue Service announces the Twentieth Annual Institute on Current Issues in International Taxation, jointly sponsored by the Internal Revenue Service and The George Washington University Law School, to be held on December 13 and 14, 2007, at the Grand Hyatt Washington Hotel in Washington, DC. Registration is currently underway for the Institute, which is intended for international tax professionals.

The program will present a unique opportunity for top IRS and Treasury officials and tax experts, OECD officials and other government tax authorities, and leading private sector specialists, to address breaking issues and present key perspectives on new developments. The first day will feature a discussion by U.S. and foreign tax authorities of current international tax controversies.

The first day will also feature sessions on the following:

- The OECD: From the Outside, Looking In
- Current Inbound and Outbound Developments
- Transfer Pricing Challenges
- International Tax Challenges: Real Cases, Real Advice
- Hot Issues in Cross-Border Mergers & Acquisitions

The second day will focus on the following topics:

- Trends in Interpreting Key Judicial Doctrines
- International Tax Controversies
- Impact of Major OECD Initiatives
- Foreign Tax Credit Planning — The Good, The Bad, and The Ugly.

On the second day, The Honorable Eric Solomon, Assistant Secretary (Tax Policy), U.S. Department of the Treasury, will deliver the luncheon address. The second day will also include an "Ask the IRS" panel featuring senior officials from the Service.

Those interested in attending or obtaining more information should contact The George Washington University Law School, at *http://www.law.gwu.edu/ciit.*

Revised Regulations Concerning Section 403(b) Tax-Sheltered Annuity Contracts; Correction

Announcement 2007–102

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains corrections to final regulations (T.D. 9340, 2007–36 I.R.B. 487) that were published in the **Federal Register** on Thursday, July 26, 2007 (72 FR 41128) providing updated guidance on section 403(b) contracts of public schools and tax-exempt organizations described in section 501(c)(3). These regulations will affect sponsors of section 403(b) contracts, administrators, participants, and beneficiaries.

DATES: The correction is effective September 25, 2007.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, John Tolleris at (202) 622–6060; concerning the regulations as applied to church-related entities, Robert Architect at (202) 283–9634 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of this correction are under section 403(b) of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9340) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.403(b)–2 is amended by revising paragraph (b)(8)(i)(A), paragraph (b)(9), second sentence, and paragraph (b)(11), fourth sentence, to read as follows:

§ 1.403(b)–2 Definitions.

* * * * *

(b) * * *

(8) * * *

(i) * * *

(A) A State, but only with respect to an employee of the State performing services for a public school;

* * * * *

(9) * * * Subject to any rules in § 1.403(b)–1, this section, and §§ 1.403(b)–3 through 1.403(b)–11 that are specifically applicable to ministers, an employee also includes a minister described in section 414(e)(5)(A) when performing services in the exercise of his or her ministry.

* * * * *

(11) * * * Includible compensation also includes any elective deferral or other amount contributed or deferred by the eligible employer at the election of the employee that would be includible in the gross income of the employee but for the rules of sections 125, 132(f)(4), 402(e)(2), 402(h)(1)(B), 402(k), or 457(b). * * *

* * * * *

Par. 3. Section 1.403(b)–3 is amended by revising paragraph (b)(3)(i), last sentence, paragraph (c)(2), last sentence, and paragraph (d)(1)(ii), last sentence, to read as follows:

§ 1.403–3 Exclusion for contributions to purchase section 403(b) contracts.

* * * * *

(b) * * *

(3) * * *

(i) * * * However, if a plan contains any optional provisions, the optional provisions must meet, in both form and operation, the relevant requirements under section 403(b), this section, and §§ 1.403(b)–4 through 1.403(b)–11.

* * * * *

(c) * * *

(2) * * * Similarly, a designated Roth account under a section 403(b) plan is subject to the rules of sections 401(a)(9)(A) and (B) and § 1.403(b)–6(e).

* * * * *

(d) * * *

(1) * * *

(ii) * * * However, any failure that is not a operational failure adversely affects all contracts issued under the plan, including: a failure to have contracts issued pursuant to a written defined contribution plan which, in form, satisfies the requirements of § 1.403(b)–1, § 1.403(b)–2, this section, and §§ 1.403(b)–4 through 1.403(b)–11 (a written plan failure); a nondiscrimination failure; or an employer eligibility failure.

* * * * *

Par. 4. Section 1.403(b)–4 is amended by revising paragraph (b)(1), third sentence, paragraph (c)(3)(i)(B)(*2*), and paragraph (e)(7), second sentence, to read as follows:

§ 1.403(b)–4 Contribution limitations.

* * * * *

(b) * * *

(1) * * * For purposes of section 415, contributions made for a participant are aggregated to the extent applicable under sections 414(b), (c), (m), (n), and (o). * * *

* * * * *

(c) * * *

(3) * * *

(i) * * *

(B) * * *

(*2*) The total elective deferrals described in section 402(g)(7)(A)(ii) made for the qualified employee by the qualified organization for prior years; or

* * * * *

(e) * * *

(7) * * * In such a case, there is first taken into account his or her service during the annual work period for which the last year of service's includible compensation is being determined; then there is taken into account his or her service during his or her next preceding annual work period based on whole months; and so forth until the employee's service equals, in the aggregate, one year of service.

* * * * *

Par. 5. Section 1.403(b)–6 is amended by revising paragraph (e)(3) and paragraph (e)(5), last sentence, to read as follows:

§ 1.403(b)–6 Timing of distributions and benefits.

* * * * *

(e) * * *

(3) * * * The required beginning date for purposes of section 403(b)(10) is April 1 of the calendar year following the later of the calendar year in which the employee attains age 70½ or the calendar year in which the employee retires from employment with the employer maintaining the plan. However, for any section 403(b) contract that is not part of a governmental plan or church plan, the required beginning date for a 5-percent owner is April 1 of the calendar year following the calendar year in which the employee attains age 70½.

* * * * *

(5) * * * See also § 1.403(b)–9(a)(5) for additional rules relating to annuities payable from a retirement income account).

* * * * *

Par. 6. Section 1.403(b)–11 is amended by revising paragraph (c)(2) to read as follows:

§ 1.403(b)–11 Applicable dates.

* * * * *

(c) * * *

(2) In the case of a loan or other extension of credit to the employer that was entered into under a retirement income account before July 26, 2007, the plan does not fail to satisfy § 1.403(b)–9(a)(2)(i)(C) on account of the loan or other extension of credit if the plan takes reasonable steps to eliminate the loan or other extension of credit to the employer before the applicable date for § 1.403(b)–9(a)(2) or as promptly as practical thereafter (including taking steps after July 26, 2007 and before the applicable date).

* * * * *

Par. 7. Section 1.414(c)–5 is amended by revising paragraph (g) *Example 3.(i)*, first sentence, to read as follows:

§ 1.414(c)–5 Certain tax-exempt organizations.

* * * * *

(g) * * *

Example 3. * * *

(*i*) * * * Organizations O and P are each tax-exempt organizations under section 501(c)(3). * * *

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on September 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 25, 2007, 72 F.R. 54351)

Section 1045 Application to Partnerships; Correction

Announcement 2007–103

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendments.

SUMMARY: This document contains corrections to final regulations (T.D. 9353, 2007–40 I.R.B. 721) that were published in the **Federal Register** on Tuesday, August 14, 2007 (72 FR 45346) relating to the application of section 1045 of the Internal Revenue Code to partnerships and their partners.

DATES: This correction is effective October 10, 2007.

FOR FURTHER INFORMATION CONTACT: Jian H. Grant at (202) 622–3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of this correction are under section 1045 of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9353) contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following amendments:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1045–1 is amended by revising the last sentence of paragraph (c)(1)(i), the subtitle of paragraph (c)(2)(i), the first five sentences of paragraph (h)(3)(i) *Example 3.*(i), the fourth sentence of (h)(3)(i) *Example 5.*(v), and the first sentence of (h)(3)(i) *Example 12.*(ii) to read as follows:

§ 1.1045–1 Application to partnerships.

* * * * *

(c) * * *

(1) * * *

(i) * * * A taxpayer other than a C corporation that sells QSB stock held for more than 6 months at the time of the sale may elect in accordance with paragraph (h) of this section to apply section 1045 if replacement QSB stock is purchased by a purchasing partnership (including a selling partnership).

* * * * *

(2) * * *

(i) *General rule.*

* * * * *

(h) * * *

(3) * * *

(i) * * *

Example 3. * * *

(i) On January 1, 2008, A, an individual, and B, an individual, each contribute $500 to UTP (upper-tier partnership) for equal partnership interests. On February 1, 2008, UTP and C, an individual, each contribute $1,000 to LTP (lower-tier partnership) for equal partnership interests. On March 1, 2008, LTP purchases QSB stock for $500. On April 1, 2008, D, an individual, joins UTP by contributing $500 to UTP for a 1/3 interest in UTP. On December 1, 2008, LTP sells the QSB stock for $2,000. * * *

* * * * *

Example 5. * * *

(v) * * * In accordance with the principles of § 1.743–1(j)(3), the amount of A's gain from the March 30, 2009, sale of replacement QSB1 stock in which A has a $200 negative basis adjustment equals $300 (A's share of PRS' gain from the sale of replacement QSB1 stock ($100), increased by the amount of A's negative basis adjustment for replacement QSB1 stock ($200)). * * *

* * * * *

Example 12. * * *

(ii) Because A purchased within 60 days of PRS' sale of the QSB stock, replacement QSB stock for a cost equal to A's share of the partnership's amount realized on the sale of the QSB stock, and because A made a valid election to apply section 1045 with respect to A's share of the gain from PRS' sale of the QSB stock, A does not recognize A's $100 distributive share of the gain from PRS' sale of the QSB stock. * * *

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on October 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2007, 72 F.R. 57487)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-104

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007

Name	Address	Designation	Date of Suspension
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007

Name	Address	Designation	Date of Suspension
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007

Name	Address	Designation	Date of Suspension
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007

Name	Address	Designation	Date of Suspension
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1.—Tax Imposed

The Service provides inflation adjustments to the tax rate tables for individuals, trusts, and estates for taxable years beginning in 2008. In addition, the amounts of certain reductions allowed against the unearned income of minor children in computing the "kiddie tax" are adjusted. Also adjusted are the amounts used to determine whether a parent may elect to report the "kiddie tax" on the parent's return. See Rev. Proc. 2007-66, page 970.

Section 23.—Adoption Expenses

The Service provides inflation adjustments to the adoption credit allowed for the adoption of a child for taxable years beginning in 2008. The Service also provides inflation adjustments to the value used in calculating the modified adjusted gross income limitations used to determine the amount of adoption credit that is allowed in taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 24.—Child Tax Credit

The Service provides inflation adjustments for the value used in determining the amount of the credit that may be refundable beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 25A.—Hope and Lifetime Learning Credits

The Service provides inflation adjustments for the amount of qualified tuition and related expenses that are taken into account in determining the amount of the Hope Scholarship Credit for taxable years beginning in 2008, and for the amount of a taxpayer's modified adjusted gross income that is taken into account in determining the reduction in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise available. See Rev. Proc. 2007-66, page 970.

Section 25B.—Elective Deferrals and IRA Contributions by Certain Individuals

The Service provides inflation adjustments to the adjusted gross income amounts used to determine the applicable percentage for calculating the qualified retirement savings contributions credit that may be allowed for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 32.—Earned Income

The Service provides inflation adjustments to the limitations on the earned income credit for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

The Service provides inflation adjustments to the amounts used to calculate the State housing credit ceiling used in determining the low-income housing credit for calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 59.—Other Definitions and Special Rules

The Service provides an inflation adjustment to the exemption amount used in computing the alternative minimum tax for a minor child subject to the "kiddie tax" for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 62.—Adjusted Gross Income Defined

The Service provides inflation adjustments to the amounts an eligible employer may pay in 2008 to certain welders and heavy equipment mechanics for rig-related expenses that are deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002–41, 2002–1 C.B. 1098. See Rev. Proc. 2007-66, page 970.

Section 63.—Taxable Income Defined

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 68.—Overall Limitation on Itemized Deductions

The Service provides inflation adjustments to the overall limitation on itemized deductions for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 132.—Certain Fringe Benefits

The Service provides inflation adjustments to the limitations on the exclusion of income for a qualified transportation fringe benefit for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 135.—Income From United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service provides inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 137.—Adoption Assistance Programs

The Service provides inflation adjustments to the maximum amount that can be excluded from an employee's gross income in connection with a qualified adoption assistance program for taxable years beginning in 2008. The Service also provides inflation adjustments to the amount used to calculate the modified adjusted gross income limitations used to determine the amount that can be excluded from an employee's gross income for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 146.—Volume Cap

The Service provides inflation adjustments to the amounts used to determine the State ceiling for the volume cap of private activity bonds for calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 148.—Arbitrage

26 CFR 1.148–5: Yield and valuation of investments.

The Service provides inflation adjustments for determining in the calendar year 2008 whether a broker's commission or similar fee with respect to the

acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable. The Service provides an inflation adjustment to the computation credit determined under section 1.148–3(d)(4) of the proposed Income Tax Regulations for bond years ending in 2008. See Rev. Proc. 2007-66, page 970.

Section 151.—Allowance of Deductions for Personal Exemptions

The Service provides inflation adjustments to the personal exemption and to the threshold amounts of adjusted gross income above which the exemption amount phases out for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 170.—Charitable, etc., Contributions and Gifts

The Service provides inflation adjustments to the "insubstantial benefit" guidelines for calendar year 2008. Under the guidelines, a charitable contribution is fully deductible even though the contributor receives "insubstantial benefits" from the charity. See Rev. Proc. 2007-66, page 970.

Section 179.—Election to Expense Certain Depreciable Business Assets

The Service provides inflation adjustments to the aggregate cost of section 179 property that a taxpayer may elect to treat as an expense for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 213.—Medical, Dental, etc., Expenses

The Service provides inflation adjustments to the limitation on the amount of eligible long-term care premiums includible in the term "medical care" for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 219.—Retirement Savings

The Service provides inflation adjustments to the applicable dollar amounts used to calculate the amount by which active participants must reduce the amount allowed as a deduction for qualified retirement contributions for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 220.—Archer MSAs

The Service provides inflation adjustments to the amounts used to determine whether a health plan is a "high deductible health plan" for purposes of determining whether an individual is eligible for a deduction for cash paid to a medical savings account for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 221.—Interest on Education Loans

The Service provides inflation adjustments to the income limitations used to determine the allowable deduction for interest on education loans for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 264.—Certain Amounts Paid in Connection With Insurance Contracts

When a welfare benefit fund is directly or indirectly a beneficiary under a life insurance policy within the meaning of section 264(a) of the Code, what are the limitations on an employer's deduction for contributions to the fund? See Rev. Rul. 2007-65, page 949.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 330 (31 USC).—Best Practices for Tax Advisors

31 CFR 10.3: Who may practice.

T.D. 9359

DEPARTMENT OF THE TREASURY
Office of the Secretary
31 CFR Part 10

Regulations Governing Practice Before the Internal Revenue Service

AGENCY: Office of the Secretary, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the regulations governing practice before the Internal Revenue Service (Circular 230). These regulations affect individuals who practice before the Internal Revenue Service (IRS). The amendments modify the general standards of practice before the IRS.

DATES: *Effective Date:* These regulations are effective September 26, 2007.

Applicability Date: For dates of applicability, see §§10.1(d), 10.2(b), 10.3(i), 10.4(e), 10.5(f), 10.6(p), 10.7(g), 10.22(c), 10.25(e), 10.27(d), 10.29(d), 10.30(e), 10.34(f), 10.50(e), 10.51(b), 10.52(b), 10.53(e), 10.60(d), 10.61(c), 10.62(d), 10.63(f), 10.65(c), 10.68(e), 10.70(c), 10.71(g), 10.72(g), 10.73(g), 10.76(e), 10.77(c), 10.78(d), 10.82(h), 10.90(b), and 10.91.

FOR FURTHER INFORMATION CONTACT: Matthew Cooper at (202) 622–4940.

SUPPLEMENTARY INFORMATION:

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department. The Secretary is authorized, after notice and an opportunity for a proceeding, to censure, suspend or disbar from practice before the Treasury Department those representatives who are incompetent, disreputable, or who violate regulations prescribed under section 330 of title 31. The Secretary also is authorized to impose a monetary penalty against these individuals or seek an injunction under section 7408 of the Internal Revenue Code.

The Secretary has published regulations governing the practice of representatives before the IRS in Circular 230 (31 CFR part 10). These regulations authorize the Director of the Office of Professional Responsibility to act upon applications for enrollment to practice before the IRS, to make inquiries with respect to matters under the Office of Professional Responsibility's jurisdiction, to institute proceedings to impose a monetary penalty or to censure, suspend or disbar a practitioner from practice before the IRS, to institute proceedings to disqualify appraisers, and to perform other duties necessary to carry out these functions.

On December 19, 2002 the Treasury Department and the IRS issued an advance notice of proposed rulemaking (2002 ANPRM) (published in the I.R.B. as Announcement 2003–5, 2003–1 C.B. 397 [67 FR 77724]), requesting comments on amendments to the regulations relating to the Office of Professional Responsibility, unenrolled practice, eligibility for enrollment, sanctions and disciplinary proceedings, contingent fees and confidentiality agreements. On February 8, 2006, the Treasury Department and the IRS published in the **Federal Register** (71 FR 6421) proposed amendments to the regulations (REG–122380–02, 2006–1 C.B. 563) reflecting consideration of the comments received in response to the 2002 ANPRM and reflecting amendments to section 330 of title 31 made by the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418) (the Jobs Act). A public hearing was held on these proposals on June 21, 2006. Written public comments responding to the proposed regulations were received. After consideration of the public comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Explanation of Revisions

Over 30 written comments were received in response to the notice of proposed rulemaking. All comments were considered and are available for public inspection upon request. A number of these comments are summarized in this preamble. The scope of these regulations is limited to practice before the IRS. These regulations do not alter or supplant ethical standards that are otherwise applicable to practitioners.

Definitions—Practice Before the Internal Revenue Service

Section 10.2(a)(4) of the final regulations adopts the proposed change without modification. The final regulations provide that practice before the IRS comprehends all matters connected with a presentation to the IRS or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS. Consistent with the Jobs Act amendment to section 330 of title 31, the final regulations provide that practice includes rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion. Several commentators stated that, notwithstanding the clarification provided by the Jobs Act, the rendition of tax advice is not, in and of itself, an act constituting practice before the IRS. The Treasury Department and IRS conclude that the rendering of written advice is practice before the IRS subject to Circular 230 when it is provided by a practitioner.

Who May Practice

Sections 10.3(a) and (b) of these final regulations clarify that an attorney or CPA is not required to file a Form 2848, *"Power of Attorney and Declaration of Representative",* with the IRS before rendering written advice covered under §10.35 or §10.37. As stated earlier in this preamble, the rendering of this advice is practice before the IRS when provided by a practitioner. Any practice before the IRS other than the rendering of written advice covered under §10.35 or §10.37 continues to require the attorney or CPA to file a Form 2848 with the IRS.

The notice of proposed rulemaking invited comments on a proposal from the Advisory Committee for Tax Exempt/Governmental Entities recommending that individuals who provide technical services to plan sponsors to maintain the tax qualified status of their retirement plans (retirement plan administrators) be authorized to practice provided they demonstrate the competency to do so.

The commentators supported this proposal provided that practice is limited to representing taxpayers with respect to qualified retirement plan issues. In light of the favorable comments and the immediate need for this program, the final regulations under §10.3(e) establish an enrolled retirement plan agent designation, subject to the limitations identified in these regulations.

These regulations generally limit the practice of enrolled retirement plan agents to representation with respect to issues arising under the following employee plan programs: (1) Employee Plans Determination Letter program; (2) Employee Plans Compliance Resolution System; and (3) Employee Plans Master and Prototype and Volume Submitter program. Enrolled retirement plan agents also are permitted to represent taxpayers generally with respect to IRS forms under the 5300 and 5500 series, which are filed by retirement plans and plan sponsors, but not with respect to actuarial forms or schedules.

The Advisory Committee recommended the implementation of procedures for enrollment similar to the current enrolled agent program. The Treasury Department and IRS adopt that recommendation. Enrolled retirement plan agents will be subject to an examination to determine competency, a renewal process and continuing professional education requirements.

Enrollment Procedures

Sections 10.4, 10.5 and 10.6 of the regulations set forth the applicable procedures relating to the enrollment and renewal of enrollment of an enrolled agent. The final regulations adopt the proposed changes in these sections with one modification. Sections 10.5(b) and 10.6(d)(6) are revised to reflect the publishing of T.D. 9288, 2006–44 I.R.B. 794 (71 FR 58740), which establishes user fees for enrollment and renewal of this enrollment in 26 CFR part 300, on October 5, 2006. The procedures in §§10.4, 10.5, and 10.6 also are expanded to include the enrollment and renewal of enrollment for the new category of enrolled retirement plan agents.

Limited Practice Before the IRS

The final regulations do not adopt the provisions governing limited practice as proposed under §10.7. Accordingly, the authorization in §10.7(c)(viii), which allows an individual, who was not otherwise a practitioner, to represent a taxpayer during an examination if that individual prepared the return for the taxable period under examination, is retained. An unenrolled return preparer who prepared the taxpayer's return for the year under examination, therefore, may continue to negotiate with the IRS on behalf of that taxpayer during an examination or bind that taxpayer to a position during an examination. The unenrolled return preparer, however, may still not represent a taxpayer before any other office of the IRS, including Collection or Appeals; execute

closing agreements, claims for refund, or waivers; or otherwise represent taxpayers before the IRS unless authorized by §10.7(c)(1)(i) through (vii).

These final regulations do not adopt one commentator's suggestion that payroll reporting agents be allowed to represent taxpayers on a limited basis with respect to Federal tax deposits made by the payroll agents on behalf of their clients. Payroll agents have not demonstrated their qualifications to practice before the IRS as required under section 330(a)(2) of title 31. Payroll agents may assist, however, in the exchange of information with the IRS regarding a taxpayer's return if the taxpayer specifically authorizes the payroll agent to receive confidential tax information from the IRS through the use of a tax information authorization.

Practice by Former Government Employees, Their Partners and Their Associates

The final regulations adopt the proposed amendments to §10.25, with modification. The final regulations modify §10.25(b)(4) to prohibit, for a period of one year after Government employment is ended, former employees from appearing before, or communicating with the intent to influence, an employee of the Treasury Department with respect to a rule in which they were involved in developing. This modification is consistent with the scope of activities covered by 18 U.S.C. 207(a) and 207(c). Commentators generally supported the changes to §10.25 governing the restrictions on the practice of former Government employees, their partners, and their associates with respect to matters that the former Government employees participated in during the course of their Government employment.

Contingent Fees

The final regulations adopt the amendments as proposed in §10.27, with several modifications. Most commentators opposed further limitations on contingent fees under §10.27 and supported the withdrawal or significant modification of this section. Specifically, several commentators stated that the proposed rules were overly broad, improperly interfered with the practitioner-client relationship, and prohibited some small and middle market taxpayers from appropriately requesting refunds. Another group of commentators requested that contingent fees be allowed in situations in which IRS review of the taxpayer's position is probable and the fees do not provide an incentive for abuse (including interest and penalty reviews, private letter rulings, pre-filing agreements, advance pricing agreements, and requests for relief under section 9100).

The Treasury Department and the IRS continue to believe that a rule restricting contingent fees for preparing tax returns supports voluntary compliance with the Federal tax laws by discouraging return positions that exploit the audit selection process. In particular, the Treasury Department and IRS are concerned with the use of contingent fee arrangements in connection with claims for refund or amended returns filed late in the examination process. Balancing these concerns with the appropriate use of contingent fee arrangements in other situations, the final regulations permit a practitioner to charge a contingent fee for services rendered in connection with the IRS examination of, or challenge, to (i) an original tax return, or (ii) an amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination or a written challenge to the original tax return.

Based on comments received, the final regulations also permit the use of contingent fees for interest and penalty reviews because there is no exploitation of the audit lottery in these situations as they are generally completed on a post-examination basis. A practitioner, therefore, may charge a contingent fee for services rendered in connection with a claim for credit or refund filed in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

Finally, the final regulations adopt the amendment in proposed §10.27 which allows a practitioner to charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

To eliminate any adverse impact that the adoption of these final regulations could have on pending or imminent transactions, §10.27(d), as amended, will apply to fee arrangements entered into after March 26, 2008.

Conflicting Interests

The final regulations adopt the proposed amendments found in §10.29 with modification. Under the final regulations, a practitioner is required to obtain consent to the representation from each affected client in writing in order to represent the conflicting interests. The written consent may vary in form. The practitioner may prepare a letter to the client outlining the conflict, as well as the possible implications of the conflict, and submit the letter to the client for the client to countersign. Unlike American Bar Association model rule 1.7, which permits affected clients to provide informed consent verbally if the consent is contemporaneously documented by the practitioner in writing, a verbal consent followed by a confirmatory letter authored by the practitioner will not satisfy §10.29 unless the confirmatory letter is countersigned by the client. A number of commentators opposed the proposed rules on the grounds that it is arguably broader than American Bar Association model rule 1.7. The Treasury Department and IRS, however, conclude that the language in the final regulations is appropriate to protect taxpayer interests and protect settlements from future collateral attack. In order to provide greater flexibility to both the practitioner and client, the Treasury Department and IRS have revised the final regulations to allow the confirmation to be made within a reasonable period after the informed consent, but in no event later than 30 days. It is not the intent of the Treasury Department and IRS to sanction minor technical violations of this final §10.29 when there is little or no injury to a client, the public, or tax administration. For example, if a client fails to return the confirmatory writing to the practitioner, notwithstanding the practitioner's documented good faith effort to obtain the client's signature, the practitioner would not be subject to a sanction or monetary penalty provided the practitioner promptly withdrew from representation upon the failure to receive the client's written confirmation within a reasonable period.

Standards With Respect to Tax Returns and Documents, Affidavits and Other Papers

Section 10.34 sets forth standards applicable to advice with respect to tax return positions and applicable to preparing or signing returns. These final regulations adopt §10.34 as proposed, with modifications.

On May 25, 2007, the President signed into law the Small Business and Work Opportunity Tax Act of 2007, Public Law 110–28 (121 Stat. 190), which amended several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the penalties for preparing a return that reflects an understatement of liability, and increase applicable penalties. On June 11, 2007, the IRS released Notice 2007–54, 2007–27 I.R.B. 12 (see §601.601(d)(2)(ii)(*b*)), providing guidance and transitional relief for the return preparer provisions under section 6694 of the Code, as recently amended. The standards with respect to tax returns under §10.34(a) in these final regulations do not reflect amendments to the Code made by the Small Business and Work Opportunity Tax Act of 2007. Rather, the Treasury Department and the IRS are reserving §10.34(a) and (e) in these final regulations and are simultaneously issuing a notice of proposed rulemaking proposing to amend this part to reflect these recent amendments to the Code.

Several commentators requested that the Treasury Department and the IRS clarify the rule concerning advising a client to submit a document that contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation and a taxpayer's right to offer a good faith challenge to a rule or regulation. The language under §10.34(b)(2)(iii) now provides that a practitioner may not advise a client to submit a document to the IRS that contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document showing a good faith challenge to the rule or regulation.

Sanctions

The final regulations adopt the amendments under §10.50 authorizing the imposition of a monetary penalty in addition to, or in lieu of, any other sanction in accordance with section 822(a) of the Jobs Act. The Treasury Department and the IRS released Notice 2007–39, 2007–20 I.R.B. 1243 (see §601.601(d)(2)(ii)(*b*)), on April 23, 2007, which provides guidance for practitioners, employers, firms, and other entities that may be subject to monetary penalties. In addition, the notice requests comments from the public regarding rules and standards relating to the imposition of the monetary penalty. The regulations also contain conforming amendments to other provisions relating to sanctions, including modifications made by section 1219 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780). The Secretary of Treasury, or delegate, after due notice and opportunity for hearing, may now disqualify an appraiser who violates Circular 230 with or without the assessment of a section 6701 penalty against the appraiser.

Incompetence and Disreputable Conduct

Section 10.51 of the regulations defines disreputable conduct for which a practitioner may be sanctioned. A number of commentators stated that inclusion of "failure to sign a tax return" as a type of disreputable conduct is inappropriate unless the rule clarifies how the practitioner should appropriately handle competing duties, including section 6694 of the Internal Revenue Code or §10.34 of Circular 230. The Treasury Department and the IRS agree that there might be instances in which the failure to sign a return should not lead to discipline. Therefore, §10.51(a)(14) of the final regulations is modified to provide that failure to sign a return is not disreputable conduct if the failure is due to reasonable cause and not due to willful neglect. This change is consistent with the standard applied under section 6695(b) of the Code.

Conferences

The final regulations adopt the proposed rule in §10.61(a) relating to the ability of the Director of the Office of Professional Responsibility to confer with a practitioner, employer, firm or other entity, or an appraiser concerning allegations of misconduct irrespective of whether a proceeding has been instituted. Commentators suggested that the practitioner, employer, firm or other entity, or an appraiser be provided with a right to a conference with the Office of Professional Responsibility. The commentators' suggestion was not adopted in light of the Office of Professional Responsibility's policy that it will not deny a first request for conference made by a practitioner, employer, firm or other entity, or an appraiser regarding allegations of misconduct. The Office of Professional Responsibility may conduct a conference by telephonic means or in person.

Service of Complaint

The final regulations adopt the rules related to service of the complaint as proposed. Proposed regulations in §10.63(d) provide that within 10 days of serving the complaint, copies of the evidence in support of the complaint must be served on the respondent in any manner provided by regulations. Commentators requested that the Director of the Office of Professional Responsibility furnish evidence not solely in support of the complaint, but also additional evidence collected during the course of investigating the conduct of the respondent, including any exculpatory evidence. Although not formalized in the regulations or the Internal Revenue Manual currently, the current practice of the Office of Professional Responsibility is to provide to the respondent upon request a copy of what informally is understood as the "OPR administrative file" prior to the filing of a complaint under §10.60. In general, the OPR administrative file contains material that the Office of Professional Responsibility considered in the course of determining whether to issue a final complaint. Some material related to the case, including but not limited to legal memoranda provided to the Office of Professional Responsibility by the Office of Chief Counsel will not be included in the OPR administrative file. The Treasury Department and IRS intend for the practice of releasing the OPR administrative file upon request to continue. This practice addresses in part commentators' concern that documents included in the investigatory file, including releasable

exculpatory evidence, be provided to the respondent. The IRS expects to issue Internal Revenue Manual provisions in the near future pertaining to the Office of Professional Responsibility's procedures for investigations. It is expected that those provisions will formalize the definition of the OPR administrative file and the current practice of providing it to the respondent upon request. In order to help ensure that a respondent has access to the evidence in support of OPR's position, as well as other evidence included in the investigatory file, the Treasury Department and IRS are considering ways in which the existing practice relating to the OPR administrative file can be formalized, and will consider addressing this issue in future published guidance.

Supplemental Charges

The final regulations adopt the rules on supplemental charges as proposed with minor revisions. Section 10.65 of the regulations provides that the Director of the Office of Professional Responsibility may file supplemental charges against a practitioner or appraiser by amending the complaint to reflect the additional charges if the practitioner or appraiser is given notice and an opportunity to prepare a defense to the supplemental charges.

Discovery, Hearings, and Publicity of Proceedings

The final regulations adopt the proposed changes to §§10.68, 10.71, and 10.72(a) through (c) without modification. Most commentators supported expanding the use of discovery in disciplinary proceedings. Most commentators also supported providing further procedural protections such as a guarantee of the right to cross-examine witnesses. Section 10.71(f) of the final regulations provides that no discovery other than that specifically provided in that section is permitted.

Section 10.72(d) regarding the publicity of disciplinary proceedings is adopted with modification. These final regulations provide that reports and decisions of the ALJ and appellate authority will be available for public inspection within 30 days after the agency's decision becomes final, subject to procedures to protect the identities of any third-party taxpayers. This publicity will provide greater transparency to the disciplinary process.

Although most commentators do not oppose disclosure if a sanction is imposed, commentators raised concerns about disclosure before the Secretary's decision is final. The concerns are that premature public disclosure will unfairly tarnish practitioners' reputations and that IRS proceedings lack the independent review and system of checks and balances found in State bar disciplinary proceedings. Several commentators specifically requested that an independent party outside of the IRS make a probable cause determination prior to disclosure.

Attorneys in the Office of Professional Responsibility review every allegation received by the office. If an allegation warrants investigation, the practitioner is provided with an opportunity to confer with the Office of Professional Responsibility regarding the allegation against the practitioner. After the conference, the Office of Professional Responsibility may close their investigation without action, or, if a violation of Circular 230 has occurred, attempt to reach an agreement with the practitioner on an appropriate sanction. If an agreement is not reached, the Office of Professional Responsibility sends the case to the Office of the Associate Chief Counsel (General Legal Services) for further action. An attorney in the Office of the Associate Chief Counsel (General Legal Services) thoroughly reviews the case file, and, if a violation of Circular 230 has occurred, the practitioner is offered one more opportunity to discuss the merits and settlement of the case before a formal complaint is filed. Only after the case has been reviewed by the Office of the Associate Chief Counsel (General Legal Services) and the practitioner has been offered this second opportunity to discuss and settle the case is a formal complaint filed.

In light of the concerns raised by commentators that premature public disclosure could potentially tarnish practitioners' reputations, the final regulations require that disclosure of the disciplinary decision be delayed until after the decision becomes final. This modification ensures that there is no potential premature tarnishing of a practitioner's reputation.

Decision of Administrative Law Judge

The final regulations do not adopt the proposed rules under §§10.77 and 10.78, which provided for a more streamlined process for deciding appeals of the Administrative Law Judges' decisions. The intent of this streamlined process was to provide a more timely process for deciding appeals. Numerous concerns were raised with the streamlined process, and, after consideration of the concerns, these final regulations keep the current rules under §§10.77 and 10.78 in effect. But to achieve a more timely review of any appeal, the regulations now provide that the Secretary of the Treasury, or delegate, should make the agency decision within 180 days after receipt of the appeal. The failure of the Secretary of the Treasury, or delegate, to meet this timeframe, as well as any other discretionary timeframe in subpart D, does not create a right of action for the practitioner.

Expedited Suspension

The final regulations adopt, with modification, the proposed amendments to §10.82. Final §10.82 expands the authority of the Office of Professional Responsibility to institute expedited suspension proceedings against practitioners who advance frivolous or obstructionist positions (after a sanction by a court of competent jurisdiction). The Treasury Department and the IRS continue to believe that the expedited suspension process is equitable and appropriate in the limited listed circumstances. The Office of Professional Responsibility completes an investigation of the issues prior to instituting an expedited proceeding and practitioners are entitled to a conference with the Office of Professional Responsibility upon request.

Several commentators expressed concern that expanding the authorized use of the expedited procedures to compliance cases further erodes a practitioner's rights to due process. After further consideration of this issue, final §10.82 does not expand the authority of the Office of Professional Responsibility to institute expedited suspension proceedings against practitioners who are not in compliance with their own Federal tax obligations (failure to file or pay a tax in 3 of the preceding 5 years, or in 4 of the preceding 7 periods).

Special Analyses

It has been determined that this final rule is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified, under the provisions of the Regulatory Flexibility Act (5 U.S.C. 601*et seq.*), that these regulations will not have a significant economic impact on a substantial number of small entities. Persons authorized to practice have long been required to comply with certain standards of conduct when practicing before the Internal Revenue Service. These regulations do not alter the basic nature of the obligations and responsibilities of these practitioners. These regulations merely clarify those obligations in response to public comments, replace certain terminology to conform with the terminology used in 18 U.S.C. 207, and 5 CFR parts 2637 and 2641 (or superseding regulations), make modifications to reflect amendments to section 330 of title 31 made by the Jobs Act, and make other modifications to reflect concerns about greater independence, transparency and due process. These regulations will not impose, or otherwise cause, a significant increase in reporting, recordkeeping, or other compliance burdens on a substantial number of small entities. A regulatory flexibility analysis, therefore, is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the regulations' impact on small businesses.

Drafting Information

The principal author of these regulations is Matthew S. Cooper of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 31 CFR part 10 is amended to read as follows:

PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Paragraph 1. The authority citation for 31 CFR part 10 continues to read as follows:

Authority: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 *et. seq.;* 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., p. 1017.

Par. 2. In Part 10, remove the language "Director of Practice" where it appears and add, in its place, the language "Director of the Office of Professional Responsibility" in each of the following sections and paragraphs:

Section 10.5(c), (d) and (e);

Section 10.6(a)(5), (b), (g)(2)(iii), (g)(2)(iv), (g)(4), (j)(1), (j)(2), (j)(4), (k)(1), (k)(2) and (n);

Section 10.7(c)(2)(iii) and (d);

Section 10.20(b) heading, (b) and (c);

Section 10.60(b);

Section 10.63(c) heading, (c);

Section 10.64(a);

Section 10.66;

Section 10.69(a)(1) and (b);

Section 10.73(a);

Section 10.79(a), (b), (c) and (d);

Section 10.80;

Section 10.81;

Section 10.82(a), (c) introductory text, (c)(3), (d), (e), (f)(1) and (g).

Par. 3. Section 10.1 is revised to read as follows:

§10.1 Director of the Office of Professional Responsibility.

(a) *Establishment of office.* The Office of Professional Responsibility is established in the Internal Revenue Service. The Director of the Office of Professional Responsibility is appointed by the Secretary of the Treasury, or delegate.

(b) *Duties.* The Director of the Office of Professional Responsibility acts on applications for enrollment to practice before the Internal Revenue Service; makes inquiries with respect to matters under the Director's jurisdiction; institutes and provides for the conduct of disciplinary proceedings relating to practitioners (and employers, firms or other entities, if applicable) and appraisers; and performs other duties as are necessary or appropriate to carry out the functions under this part or as are otherwise prescribed by the Secretary of the Treasury, or delegate.

(c) *Acting Director of the Office of Professional Responsibility.* The Secretary of the Treasury, or delegate, will designate an officer or employee of the Treasury Department to act as Director of the Office of Professional Responsibility in the absence of the Director or during a vacancy in that office.

(d) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 4. Section 10.2 is revised to read as follows:

§10.2 Definitions.

(a) As used in this part, except where the text provides otherwise—

(1) *Attorney* means any person who is a member in good standing of the bar of the highest court of any state, territory, or possession of the United States, including a Commonwealth, or the District of Columbia.

(2) *Certified public accountant* means any person who is duly qualified to practice as a certified public accountant in any state, territory, or possession of the United States, including a Commonwealth, or the District of Columbia.

(3) *Commissioner* refers to the Commissioner of Internal Revenue.

(4) *Practice before the Internal Revenue Service* comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion, and representing a client at conferences, hearings and meetings.

(5) *Practitioner* means any individual described in paragraphs (a), (b), (c), (d) or (e) of §10.3.

(6) A *tax return* includes an amended tax return and a claim for refund.

(7) *Service* means the Internal Revenue Service.

(b) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 5. Section 10.3 is amended by:

(1) Revising paragraphs (a) and (b).

(2) Redesignating paragraphs (e), (f), and (g) as paragraphs (f), (g), and (h) respectively.

(3) Adding new paragraphs (e) and (i).

The revisions and additions read as follows:

§10.3 Who may practice.

(a) *Attorneys.* Any attorney who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that the attorney is currently qualified as an attorney and is authorized to represent the party or parties. Notwithstanding the preceding sentence, attorneys who are not currently under suspension or disbarment from practice before the Internal Revenue Service are not required to file a written declaration with the IRS before rendering written advice covered under §10.35 or §10.37, but their rendering of this advice is practice before the Internal Revenue Service.

(b) *Certified public accountants.* Any certified public accountant who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that the certified public accountant is currently qualified as a certified public accountant and is authorized to represent the party or parties. Notwithstanding the preceding sentence, certified public accountants who are not currently under suspension or disbarment from practice before the Internal Revenue Service are not required to file a written declaration with the IRS before rendering written advice covered under §10.35 or §10.37, but their rendering of this advice is practice before the Internal Revenue Service.

* * * * *

(e) *Enrolled Retirement Plan Agents*—(1) Any individual enrolled as a retirement plan agent pursuant to this part who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service.

(2) Practice as an enrolled retirement plan agent is limited to representation with respect to issues involving the following programs: Employee Plans Determination Letter program; Employee Plans Compliance Resolution System; and Employee Plans Master and Prototype and Volume Submitter program. In addition, enrolled retirement plan agents are generally permitted to represent taxpayers with respect to IRS forms under the 5300 and 5500 series which are filed by retirement plans and plan sponsors, but not with respect to actuarial forms or schedules.

(3) An individual who practices before the Internal Revenue Service pursuant to paragraph (e)(1) of this section is subject to the provisions of this part in the same manner as attorneys, certified public accountants and enrolled agents.

* * * * *

(i) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 6. Section 10.4 is revised to read as follows:

§10.4 Eligibility for enrollment as enrolled agent or enrolled retirement plan agent.

(a) *Enrollment as an enrolled agent upon examination.* The Director of the Office of Professional Responsibility may grant enrollment as an enrolled agent to an applicant who demonstrates special competence in tax matters by written examination administered by, or administered under the oversight of, the Director of the Office of Professional Responsibility and who has not engaged in any conduct that would justify the censure, suspension, or disbarment of any practitioner under the provisions of this part.

(b) *Enrollment as a retirement plan agent upon examination.* The Director of the Office of Professional Responsibility may grant enrollment as an enrolled retirement plan agent to an applicant who demonstrates special competence in qualified retirement plan matters by written examination administered by, or administered under the oversight of, the Director of the Office of Professional Responsibility and who has not engaged in any conduct that would justify the censure, suspension, or disbarment of any practitioner under the provisions of this part.

(c) *Enrollment of former Internal Revenue Service employees.* The Director of the Office of Professional Responsibility may grant enrollment as an enrolled agent or enrolled retirement plan agent to an applicant who, by virtue of past service and technical experience in the Internal Revenue Service, has qualified for such enrollment and who has not engaged in any conduct that would justify the censure, suspension, or disbarment of any practitioner under the provisions of this part, under the following circumstances—

(1) The former employee applies for enrollment to the Director of the Office of Professional Responsibility on a form supplied by the Director of the Office of Professional Responsibility and supplies the information requested on the form and such other information regarding the experience and training of the applicant as may be relevant.

(2) An appropriate office of the Internal Revenue Service, at the request of the Director of the Office of Professional Responsibility, will provide the Director of the Office of Professional Responsibility with a detailed report of the nature and rating of the applicant's work while employed by the Internal Revenue Service and a recommendation whether such employment qualifies the applicant technically or otherwise for the desired authorization.

(3) Enrollment as an enrolled agent based on an applicant's former employment with the Internal Revenue Service may be of unlimited scope or it may be limited to permit the presentation of matters only of the particular class or only before the particular unit or division of the Internal Revenue Service for which the applicant's former employment has qualified the applicant. Enrollment as an enrolled retirement plan agent based on an applicant's former employment with the Internal Revenue Service will be limited to permit the presentation of matters only with respect to qualified retirement plan matters.

(4) Application for enrollment as an enrolled agent or enrolled retirement plan agent based on an applicant's former employment with the Internal Revenue Ser-

vice must be made within 3 years from the date of separation from such employment.

(5) An applicant for enrollment as an enrolled agent who is requesting such enrollment based on former employment with the Internal Revenue Service must have had a minimum of 5 years continuous employment with the Internal Revenue Service during which the applicant must have been regularly engaged in applying and interpreting the provisions of the Internal Revenue Code and the regulations relating to income, estate, gift, employment, or excise taxes.

(6) An applicant for enrollment as an enrolled retirement plan agent who is requesting such enrollment based on former employment with the Internal Revenue Service must have had a minimum of 5 years continuous employment with the Internal Revenue Service during which the applicant must have been regularly engaged in applying and interpreting the provisions of the Internal Revenue Code and the regulations relating to qualified retirement plan matters.

(7) For the purposes of paragraphs (b)(5) and (b)(6) of this section, an aggregate of 10 or more years of employment in positions involving the application and interpretation of the provisions of the Internal Revenue Code, at least 3 of which occurred within the 5 years preceding the date of application, is the equivalent of 5 years continuous employment.

(d) *Natural persons.* Enrollment to practice may be granted only to natural persons.

(e) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 7. Section 10.5 is amended by revising the section heading and paragraphs (a) and (b) and adding paragraph (f) to read as follows:

§10.5 Application for enrollment as an enrolled agent or enrolled retirement plan agent.

(a) *Form; address.* An applicant for enrollment as an enrolled agent or enrolled retirement plan agent must apply as required by forms or procedures established and published by the Office of Professional Responsibility, including proper execution of required forms under oath or affirmation. The address on the application will be the address under which a successful applicant is enrolled and is the address to which all correspondence concerning enrollment will be sent.

(b) *Fee.* A reasonable nonrefundable fee will be charged for each application for enrollment as an enrolled agent filed with the Director of the Office of Professional Responsibility in accordance with 26 CFR 300.5. A reasonable nonrefundable fee will be charged for each application for enrollment as an enrolled retirement plan agent filed with the Director of the Office of Professional Responsibility.

* * * * *

(f) *Effective/applicability date.* This section is applicable to enrollment applications received on or after September 26, 2007.

Par. 8. Section 10.6 is amended by:

1. Revising the section heading.
2. Removing paragraph (a).
3. Redesignating paragraph (c) as paragraph (a).
4. Adding new paragraphs (c) and (p).
5. Revising paragraphs (d) introductory text, (d)(4), (d)(5), (d)(6), (d)(7), (e), (f)(1), (f)(2)(iv)(A), (g)(5), (k)(4), (k)(7) and (l).

The revisions and additions read as follows:

§10.6 Enrollment as an enrolled agent or enrolled retirement plan agent.

* * * * *

(c) *Change of address.* An enrolled agent or enrolled retirement plan agent must send notification of any change of address to the address specified by the Director of the Office of Professional Responsibility. This notification must include the enrolled agent's or enrolled retirement plan agent's name, prior address, new address, social security number or tax identification number and the date.

(d) *Renewal of enrollment.* To maintain active enrollment to practice before the Internal Revenue Service, each individual is required to have the enrollment renewed. Failure to receive notification from the Director of the Office of Professional Responsibility of the renewal requirement will not be justification for the individual's failure to satisfy this requirement.

* * * * *

(4) Thereafter, applications for renewal as an enrolled agent will be required between November 1 and January 31 of every subsequent third year as specified in paragraph (d)(1), (2) or (3) of this section according to the last number of the individual's social security number or tax identification number. Those individuals who receive initial enrollment as an enrolled agent after November 1 and before April 2 of the applicable renewal period will not be required to renew their enrollment before the first full renewal period following the receipt of their initial enrollment. Applications for renewal as an enrolled retirement plan agent will be required of all enrolled retirement plan agents between April 1 and June 30 of every third year period subsequent to their initial enrollment.

(5) The Director of the Office of Professional Responsibility will notify the individual of the renewal of enrollment and will issue the individual a card evidencing enrollment.

(6) A reasonable nonrefundable fee will be charged for each application for renewal of enrollment as an enrolled agent filed with the Director of the Office of Professional Responsibility in accordance with 26 CFR 300.6. A reasonable nonrefundable fee will be charged for each application for renewal of enrollment as an enrolled retirement plan agent filed with the Director of the Office of Professional Responsibility.

(7) Forms required for renewal may be obtained by sending a written request to the Director of the Office of Professional Responsibility, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224 or from such other source as the Director of the Office of Professional Responsibility will publish in the Internal Revenue Bulletin (see 26 CFR 601.601(d)(2)(ii)(*b*)) and on the Internal Revenue Service webpage (*www.irs.gov*).

(e) *Condition for renewal: continuing professional education.* In order to qualify for renewal of enrollment, an individual enrolled to practice before the Internal Revenue Service must certify, on the application for renewal form prescribed by the Director of the Office of Professional Responsibility, that he or she has satisfied the following continuing professional education requirements.

(1) *Definitions.* For purposes of this section—

(i) *Enrollment year* means January 1 to December 31 of each year of an enrollment cycle.

(ii) *Enrollment cycle* means the three successive enrollment years preceding the effective date of renewal.

(iii) The *effective date of renewal* is the first day of the fourth month following the close of the period for renewal described in paragraph (d) of this section.

(2) *For renewed enrollment effective after December 31, 2006*—(i) *Requirements for enrollment cycle*. A minimum of 72 hours of continuing education credit must be completed during each enrollment cycle.

(ii) *Requirements for enrollment year*. A minimum of 16 hours of continuing education credit, including 2 hours of ethics or professional conduct, must be completed during each enrollment year of an enrollment cycle.

(iii) *Enrollment during enrollment cycle*—(A) *In general*. Subject to paragraph (e)(2)(iii)(B) of this section, an individual who receives initial enrollment during an enrollment cycle must complete 2 hours of qualifying continuing education credit for each month enrolled during the enrollment cycle. Enrollment for any part of a month is considered enrollment for the entire month.

(B) *Ethics*. An individual who receives initial enrollment during an enrollment cycle must complete 2 hours of ethics or professional conduct for each enrollment year during the enrollment cycle. Enrollment for any part of an enrollment year is considered enrollment for the entire year.

(f) *Qualifying continuing education*—(1) *General*. (i) *Enrolled agents*. To qualify for continuing education credit for an enrolled agent, a course of learning must—

(A) Be a qualifying program designed to enhance professional knowledge in Federal taxation or Federal tax related matters (programs comprised of current subject matter in Federal taxation or Federal tax related matters, including accounting, tax preparation software and taxation or ethics);

(B) Be a qualifying program consistent with the Internal Revenue Code and effective tax administration; and

(C) Be sponsored by a qualifying sponsor.

(ii) *Enrolled retirement plan agents*. To qualify for continuing education credit for an enrolled retirement plan agent, a course of learning must—

(i) Be a qualifying program designed to enhance professional knowledge in qualified retirement plan matters;

(ii) Be a qualifying program consistent with the Internal Revenue Code and effective tax administration; and

(iii) Be sponsored by a qualifying sponsor.

(2) * * *

(iv) *Credit for published articles, books, etc*. (A) For enrolled agents, continuing education credit will be awarded for publications on Federal taxation or Federal tax related matters, including accounting, tax preparation software, and taxation or ethics, provided the content of such publications is current and designed for the enhancement of the professional knowledge of an individual enrolled to practice before the Internal Revenue Service. The publication must be consistent with the Internal Revenue Code and effective tax administration. For enrolled retirement plan agents, continuing education credit will be awarded for publications on qualified retirement plan matters, provided the content of such publications is current and designed for the enhancement of the professional knowledge of an individual enrolled to practice as an enrolled retirement plan agent before the Internal Revenue Service. The publication must be consistent with the Internal Revenue Code and effective tax administration.

* * * * *

(g) * * *

(5) *Sponsor renewal*. (i) *In general*. A sponsor maintains its status as a qualified sponsor during the sponsor enrollment cycle.

(ii) *Renewal period*. Each sponsor must file an application to renew its status as a qualified sponsor between May 1 and July 31, 2008. Thereafter, applications for renewal will be required between May 1 and July 31 of every subsequent third year.

(iii) *Effective date of renewal*. The effective date of renewal is the first day of the third month following the close of the renewal period.

(iv) *Sponsor enrollment cycle*. The sponsor enrollment cycle is the three successive calendar years preceding the effective date of renewal.

* * * * *

(k) * * *

(4) Individuals placed in inactive enrollment status and individuals ineligible to practice before the Internal Revenue Service may not state or imply that they are enrolled to practice before the Internal Revenue Service, or use the terms enrolled agent or enrolled retirement plan agent, the designations "EA" or "ERPA" or other form of reference to eligibility to practice before the Internal Revenue Service.

* * * * *

(7) Inactive enrollment status is not available to an individual who is the subject of a disciplinary matter in the Office of Professional Responsibility.

(l) *Inactive retirement status*. An individual who no longer practices before the Internal Revenue Service may request being placed in an inactive retirement status at any time and such individual will be placed in an inactive retirement status. The individual will be ineligible to practice before the Internal Revenue Service. Such individual must file a timely application for renewal of enrollment at each applicable renewal or enrollment period as provided in this section. An individual who is placed in an inactive retirement status may be reinstated to an active enrollment status by filing an application for renewal of enrollment and providing evidence of the completion of the required continuing professional education hours for the enrollment cycle. Inactive retirement status is not available to an individual who is the subject of a disciplinary matter in the Office of Professional Responsibility.

* * * * *

(p) *Effective/applicability date*. This section is applicable to enrollment effective on or after September 26, 2007.

Par. 9. Section 10.7 is amended by:

1. Revising paragraph (c)(2)(ii).

2. And adding paragraph (g).

The revisions and additions read as follows:

§10.7 Representing oneself; participating in rulemaking; limited practice; special appearances; and return preparation.

* * * * *

(c) * * *

(2) * * *

(ii) The Director, after notice and opportunity for a conference, may deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify a sanction under §10.50.

* * * * *

(g) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 10. Section 10.22 is amended by revising paragraph (b) and adding paragraph (c) to read as follows:

§10.22 Diligence as to accuracy.

* * * * *

(b) *Reliance on others.* Except as provided in §§10.34, 10.35, and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 11. Section 10.25 is revised to read as follows:

§10.25 Practice by former government employees, their partners and their associates.

(a) *Definitions.* For purposes of this section—

(1) *Assist* means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly, or indirectly.

(2) *Government employee* is an officer or employee of the United States or any agency of the United States, including a special Government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) *Member of a firm* is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) *Particular matter involving specific parties* is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

(5) *Rule* includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions, revenue rulings, and revenue procedures published in the Internal Revenue Bulletin (see 26 CFR 601.601(d)(2)(ii)(*b*)).

(b) *General rules*—(1) No former Government employee may, subsequent to Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.

(2) No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after Government employment is ended, communicate with or appear before, with the intent to influence, any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated in, or for which, within a period of one year prior to the termination of Government employment, the former government employee had official responsibility. This paragraph (b)(4) does not, however, preclude any former employee from appearing on one's own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of a rule with respect to that particular matter, provided that the representation is otherwise consistent with the other provisions of this section and the former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) *Firm representation*—(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the Director of the Office of Professional Responsibility.

(d) *Pending representation.* The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 12. Section 10.27 is revised to read as follows:

§10.27 Fees.

(a) *In general.* A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

(b) *Contingent fees*—(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) *Definitions*. For purposes of this section—

(1) *Contingent fee* is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) *Matter before the Internal Revenue Service* includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) *Effective/applicability date*. This section is applicable for fee arrangements entered into after March 26, 2008.

Par. 13. Section 10.29 is revised to read as follows:

§10.29 Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if—

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person, or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if—

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law; and

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) *Effective/applicability date*. This section is applicable on September 26, 2007.

Par. 14. Section 10.30(a)(1) is revised and paragraph (e) is added to read as follows:

§10.30 Solicitation.

(a) *Advertising and solicitation restrictions*.

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form or public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents or enrolled retirement plan agents, in describing their professional designation, may not utilize the term of art "certified" or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are "enrolled to represent taxpayers before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," and "admitted to practice before the Internal Revenue Service." Similarly, examples of acceptable descriptions for enrolled retirement plan agents are "enrolled to represent taxpayers before the Internal Revenue Service as a retirement plan agent" and "enrolled to practice before the Internal Revenue Service as a retirement plan agent."

* * * * *

(e) *Effective/applicability date*. This section is applicable on September 26, 2007.

Par. 15. Section 10.34 is revised to read as follows:

§10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) [Reserved].

(b) *Documents, affidavits and other papers*—(1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or

other paper to the Internal Revenue Service—

(i) The purpose of which is to delay or impede the administration of the Federal tax laws;

(ii) That is frivolous; or

(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) *Advising clients on potential penalties*—(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to—

(i) A position taken on a tax return if—

(A) The practitioner advised the client with respect to the position; or

(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) *Relying on information furnished by clients.* A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) [Reserved].

(f) *Effective/applicability date.* Section 10.34 is applicable to tax returns, documents, affidavits and other papers filed on or after September 26, 2007.

Par. 16. In §10.35(b)(1) remove the language "§10.2(e)" and add the language "§10.2(a)(5)" in its place.

Par. 17. Section 10.50 is revised to read as follows:

§10.50 Sanctions.

(a) *Authority to censure, suspend, or disbar.* The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend, or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of §10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of §10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

(b) *Authority to disqualify.* The Secretary of Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

(1) If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Director of the Office of Professional Responsibility pursuant to §10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

(c) *Authority to impose monetary penalty*—(1) *In general.* (i) The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) *Amount of penalty.* The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

(3) *Coordination with other sanctions.* Subject to paragraph (c)(2) of this section—

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

(d) *Sanctions to be imposed.* The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(e) *Effective/applicability date.* This section is applicable to conduct occurring on or after September 26, 2007, except paragraph (c) which applies to prohibited conduct that occurs after October 22, 2004.

Par. 18. Section 10.51 is revised to read as follows:

§10.51 Incompetence and disreputable conduct.

(a) *Incompetence and disreputable conduct.* Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to—

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giv-

ing of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term "information."

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.

(b) *Effective/applicability date.* This section is applicable to conduct occurring on or after September 26, 2007.

Par. 19. Section 10.52 is revised to read as follows:

§10.52 Violations subject to sanction.

(a) A practitioner may be sanctioned under §10.50 if the practitioner—

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §§10.34, 10.35, 10.36 or 10.37.

(b) *Effective/applicability date.* This section is applicable to conduct occurring on or after September 26, 2007.

Par. 20. Section 10.53 is revised to read as follows:

§10.53 Receipt of information concerning practitioner.

(a) *Officer or employee of the Internal Revenue Service.* If an officer or employee of the Internal Revenue Service has reason to believe that a practitioner has violated any provision of this part, the officer or employee will promptly make a written report to the Director of the Office of Professional Responsibility of the suspected violation. The report will explain the facts and reasons upon which the officer's or employee's belief rests.

(b) *Other persons.* Any person other than an officer or employee of the Internal Revenue Service having information of a violation of any provision of this part may make an oral or written report of the alleged violation to the Director of the Office of Professional Responsibility or any officer or employee of the Internal Revenue Service. If the report is made to an officer or employee of the Internal Revenue Service, the officer or employee will make a written report of the suspected violation to the Director of the Office of Professional Responsibility.

(c) *Destruction of report.* No report made under paragraph (a) or (b) of this section shall be maintained by the Director of the Office of Professional Responsibility unless retention of the report is permissible under the applicable records con-

trol schedule as approved by the National Archives and Records Administration and designated in the Internal Revenue Manual. The Director of the Office of Professional Responsibility must destroy the reports as soon as permissible under the applicable records control schedule.

(d) *Effect on proceedings under subpart D*. The destruction of any report will not bar any proceeding under subpart D of this part, but will preclude the Director of the Office of Professional Responsibility's use of a copy of the report in a proceeding under subpart D of this part.

(e) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 21. Section 10.60 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§10.60 Institution of proceeding.

(a) Whenever the Director of the Office of Professional Responsibility determines that a practitioner (or employer, firm or other entity, if applicable) violated any provision of the laws governing practice before the Internal Revenue Service or the regulations in this part, the Director of the Office of Professional Responsibility may reprimand the practitioner or, in accordance with §10.62, institute a proceeding for a sanction described in §10.50. A proceeding is instituted by the filing of a complaint, the contents of which are more fully described in §10.62.

* * * * *

(d) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 22. Section 10.61 is revised to read as follows:

§10.61 Conferences.

(a) *In general.* The Director of the Office of Professional Responsibility may confer with a practitioner, employer, firm or other entity, or an appraiser concerning allegations of misconduct irrespective of whether a proceeding has been instituted. If the conference results in a stipulation in connection with an ongoing proceeding in which the practitioner, employer, firm or other entity, or appraiser is the respondent, the stipulation may be entered in the record by either party to the proceeding.

(b) *Voluntary sanction—*(1) *In general.* In lieu of a proceeding being instituted or continued under §10.60(a), a practitioner or appraiser (or employer, firm or other entity, if applicable) may offer a consent to be sanctioned under §10.50.

(2) *Discretion; acceptance or declination.* The Director of the Office of Professional Responsibility may, in his or her discretion, accept or decline the offer described in paragraph (b)(1) of this section. In any declination, the Director of the Office of Professional Responsibility may state that he or she would accept the offer described in paragraph (b)(1) of this section if it contained different terms. The Director of the Office of Professional Responsibility may, in his or her discretion, accept or reject a revised offer submitted in response to the declination or may counteroffer and act upon any accepted counteroffer.

(c) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 23. Section 10.62 is revised to read as follows:

§10.62 Contents of complaint.

(a) *Charges.* A complaint must name the respondent, provide a clear and concise description of the facts and law that constitute the basis for the proceeding, and be signed by the Director of the Office of Professional Responsibility or a person representing the Director of the Office of Professional Responsibility under §10.69(a)(1). A complaint is sufficient if it fairly informs the respondent of the charges brought so that the respondent is able to prepare a defense.

(b) *Specification of sanction.* The complaint must specify the sanction sought by the Director of the Office of Professional Responsiblity against the practitioner or appraiser. If the sanction sought is a suspension, the duration of the suspension sought must be specified.

(c) *Demand for answer.* The Director of the Office of Professional Responsibility must, in the complaint or in a separate paper attached to the complaint, notify the respondent of the time for answering the complaint, which may not be less than 30 days from the date of service of the complaint, the name and address of the Administrative Law Judge with whom the answer must be filed, the name and address of the person representing the Director of the Office of Professional Responsibility to whom a copy of the answer must be served, and that a decision by default may be rendered against the respondent in the event an answer is not filed as required.

(d) *Effective/applicability date.* This section is applicable to complaints brought on or after September 26, 2007.

Par. 24. Section 10.63 is amended by:

1. Revising the section heading and paragraph (a)(4).

2. Redesignating paragraph (d) as paragraph (e).

3. Adding new paragraphs (d) and (f).

The revision and additions read as follows:

§10.63 Service of complaint; service of other papers; service of evidence in support of complaint; filing of papers.

(a) * * *

(4) For purposes of this section, *respondent* means the practitioner, employer, firm or other entity, or appraiser named in the complaint or any other person having the authority to accept mail on behalf of the practitioner, employer, firm or other entity, or appraiser.

* * * * *

(d) *Service of evidence in support of complaint.* Within 10 days of serving the complaint, copies of the evidence in support of the complaint must be served on the respondent in any manner described in paragraphs (a)(2) and (3) of this section.

* * * * *

(f) *Effective/applicability date.* This section is applicable to complaints brought on or after September 26, 2007.

Par. 25. Section 10.65 is revised to read as follows:

§10.65 Supplemental charges.

(a) *In general.* The Director of the Office of Professional Responsibility may file supplemental charges, by amending the complaint with the permission of the Administrative Law Judge, against the respondent, if, for example—

(1) It appears that the respondent, in the answer, falsely and in bad faith, denies a material allegation of fact in the complaint or states that the respondent has insuffi-

cient knowledge to form a belief, when the respondent possesses such information; or

(2) It appears that the respondent has knowingly introduced false testimony during the proceedings against the respondent.

(b) *Hearing*. The supplemental charges may be heard with other charges in the case, provided the respondent is given due notice of the charges and is afforded a reasonable opportunity to prepare a defense to the supplemental charges.

(c) *Effective/applicability date*. This section is applicable on September 26, 2007.

Par. 26. Section 10.68 is revised to read as follows:

§10.68 Motions and requests.

(a) *Motions*—(1) *In general*. At any time after the filing of the complaint, any party may file a motion with the Administrative Law Judge. Unless otherwise ordered by the Administrative Law Judge, motions must be in writing and must be served on the opposing party as provided in §10.63(b). A motion must concisely specify its grounds and the relief sought, and, if appropriate, must contain a memorandum of facts and law in support.

(2) *Summary adjudication*. Either party may move for a summary adjudication upon all or any part of the legal issues in controversy. If the non-moving party opposes summary adjudication in the moving party's favor, the non-moving party must file a written response within 30 days unless ordered otherwise by the Administrative Law Judge.

(3) *Good Faith*. A party filing a motion for extension of time, a motion for postponement of a hearing, or any other non-dispositive or procedural motion must first contact the other party to determine whether there is any objection to the motion, and must state in the motion whether the other party has an objection.

(b) *Response*. Unless otherwise ordered by the Administrative Law Judge, the nonmoving party is not required to file a response to a motion. If the Administrative Law Judge does not order the nonmoving party to file a response, and the nonmoving party files no response, the nonmoving party is deemed to oppose the motion. If a nonmoving party does not respond within 30 days of the filing of a motion for decision by default for failure to file a timely answer or for failure to prosecute, the nonmoving party is deemed not to oppose the motion.

(c) *Oral motions; oral argument*—(1) The Administrative Law Judge may, for good cause and with notice to the parties, permit oral motions and oral opposition to motions.

(2) The Administrative Law Judge may, within his or her discretion, permit oral argument on any motion.

(d) *Orders*. The Administrative Law Judge should issue written orders disposing of any motion or request and any response thereto.

(e) *Effective/applicability date*. This section is applicable on September 26, 2007.

Par. 27. Section 10.70 is amended by revising paragraphs (a) and (b)(6) and adding paragraph (c) to read as follows:

§10.70 Administrative Law Judge.

(a) *Appointment*. Proceedings on complaints for the sanction (as described in §10.50) of a practitioner, employer, firm or other entity, or appraiser will be conducted by an Administrative Law Judge appointed as provided by 5 U.S.C. 3105.

(b) * * *

(6) Take or authorize the taking of depositions or answers to requests for admission;

* * * * *

(c) *Effective/applicability date*. This section is applicable on September 26, 2007.

Par. 28(a). Section 10.73 is removed.

Par. 28(b). Sections 10.71 and 10.72 are redesignated as §§10.72 and 10.73, respectively.

Par. 29. New §10.71 is added to read as follows:

§10.71 Discovery.

(a) *In general*. Discovery may be permitted, at the discretion of the Administrative Law Judge, only upon written motion demonstrating the relevance, materiality and reasonableness of the requested discovery and subject to the requirements of §10.72(d)(2) and (3). Within 10 days of receipt of the answer, the Administrative Law Judge will notify the parties of the right to request discovery and the timeframes for filing a request. A request for discovery, and objections, must be filed in accordance with §10.68. In response to a request for discovery, the Administrative Law Judge may order—

(1) Depositions upon oral examination; or

(2) Answers to requests for admission.

(b) *Depositions upon oral examination*—(1) A deposition must be taken before an officer duly authorized to administer an oath for general purposes or before an officer or employee of the Internal Revenue Service who is authorized to administer an oath in Federal tax law matters.

(2) In ordering a deposition, the Administrative Law Judge will require reasonable notice to the opposing party as to the time and place of the deposition. The opposing party, if attending, will be provided the opportunity for full examination and cross-examination of any witness.

(3) Expenses in the reporting of depositions shall be borne by the party at whose instance the deposition is taken. Travel expenses of the deponent shall be borne by the party requesting the deposition, unless otherwise authorized by Federal law or regulation.

(c) *Requests for admission*. Any party may serve on any other party a written request for admission of the truth of any matters which are not privileged and are relevant to the subject matter of this proceeding. Requests for admission shall not exceed a total of 30 (including any subparts within a specific request) without the approval from the Administrative Law Judge.

(d) *Limitations*. Discovery shall not be authorized if—

(1) The request fails to meet any requirement set forth in paragraph (a) of this section;

(2) It will unduly delay the proceeding;

(3) It will place an undue burden on the party required to produce the discovery sought;

(4) It is frivolous or abusive;

(5) It is cumulative or duplicative;

(6) The material sought is privileged or otherwise protected from disclosure by law;

(7) The material sought relates to mental impressions, conclusions, or legal theories of any party, attorney, or other representative, of a party prepared in anticipation of a proceeding; or

(8) The material sought is available generally to the public, equally to the parties, or to the party seeking the discovery through another source.

(e) *Failure to comply.* Where a party fails to comply with an order of the Administrative Law Judge under this section, the Administrative Law Judge may, among other things, infer that the information would be adverse to the party failing to provide it, exclude the information from evidence or issue a decision by default.

(f) *Other discovery.* No discovery other than that specifically provided for in this section is permitted.

(g) *Effective/applicability date.* This section is applicable to proceedings initiated on or after September 26, 2007.

Par. 30. Newly designated §10.72 is amended by:

1. Redesignating paragraphs (b), (c) and (d) as paragraphs (d), (e) and (f), respectively.

2. Revising paragraph (a) and newly designated paragraph (d).

3. Adding new paragraphs (b), (c) and (g).

The additions and revisions read as follows:

§10.72 Hearings.

(a) *In general*—(1) *Presiding officer.* An Administrative Law Judge will preside at the hearing on a complaint filed under §10.60 for the sanction of a practitioner, employer, firm or other entity, or appraiser.

(2) *Time for hearing.* Absent a determination by the Administrative Law Judge that, in the interest of justice, a hearing must be held at a later time, the Administrative Law Judge should, on notice sufficient to allow proper preparation, schedule the hearing to occur no later than 180 days after the time for filing the answer.

(3) *Procedural requirements.* (i) Hearings will be stenographically recorded and transcribed and the testimony of witnesses will be taken under oath or affirmation.

(ii) Hearings will be conducted pursuant to 5 U.S.C. 556.

(iii) A hearing in a proceeding requested under §10.82(g) will be conducted *de novo.*

(iv) An evidentiary hearing must be held in all proceedings prior to the issuance of a decision by the Administrative Law Judge unless—

(A) The Director of the Office of Professional Responsibility withdraws the complaint;

(B) A decision is issued by default pursuant to §10.64(d);

(C) A decision is issued under §10.82(e);

(D) The respondent requests a decision on the written record without a hearing; or

(E) The Administrative Law Judge issues a decision under §10.68(d) or rules on another motion that disposes of the case prior to the hearing.

(b) *Cross-examination.* A party is entitled to present his or her case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct cross-examination, in the presence of the Administrative Law Judge, as may be required for a full and true disclosure of the facts. This paragraph (b) does not limit a party from presenting evidence contained within a deposition when the Administrative Law Judge determines that the deposition has been obtained in compliance with the rules of this subpart D.

(c) *Prehearing memorandum.* Unless otherwise ordered by the Administrative Law Judge, each party shall file, and serve on the opposing party or the opposing party's representative, prior to any hearing, a prehearing memorandum containing—

(1) A list (together with a copy) of all proposed exhibits to be used in the party's case in chief;

(2) A list of proposed witnesses, including a synopsis of their expected testimony, or a statement that no witnesses will be called;

(3) Identification of any proposed expert witnesses, including a synopsis of their expected testimony and a copy of any report prepared by the expert or at his or her direction; and

(4) A list of undisputed facts.

(d) *Publicity*—(1) *In general.* All reports and decisions of the Secretary of the Treasury, or delegate, including any reports and decisions of the Administrative Law Judge, under this Subpart D are, subject to the protective measures in paragraph (d)(4) of this section, public and open to inspection within 30 days after the agency's decision becomes final.

(2) *Request for additional publicity.* The Administrative Law Judge may grant a request by a practitioner or appraiser that all the pleadings and evidence of the disciplinary proceeding be made available for inspection where the parties stipulate in advance to adopt the protective measures in paragraph (d)(4) of this section.

(3) *Returns and return information*—(i) *Disclosure to practitioner or appraiser.* Pursuant to section 6103(l)(4) of the Internal Revenue Code, the Secretary of the Treasury, or delegate, may disclose returns and return information to any practitioner or appraiser, or to the authorized representative of the practitioner or appraiser, whose rights are or may be affected by an administrative action or proceeding under this subpart D, but solely for use in the action or proceeding and only to the extent that the Secretary of the Treasury, or delegate, determines that the returns or return information are or may be relevant and material to the action or proceeding.

(ii) *Disclosure to officers and employees of the Department of the Treasury.*

Pursuant to section 6103(l)(4)(B) of the Internal Revenue Code, the Secretary of the Treasury, or delegate, may disclose returns and return information to officers and employees of the Department of the Treasury for use in any action or proceeding under this subpart D, to the extent necessary to advance or protect the interests of the United States.

(iii) *Use of returns and return information.* Recipients of returns and return information under this paragraph (d)(3) may use the returns or return information solely in the action or proceeding, or in preparation for the action or proceeding, with respect to which the disclosure was made.

(iv) *Procedures for disclosure of returns and return information.* When providing returns or return information to the practitioner or appraiser, or authorized representative, the Secretary of the Treasury, or delegate, will—

(A) Redact identifying information of any third party taxpayers and replace it with a code;

(B) Provide a key to the coded information; and

(C) Notify the practitioner or appraiser, or authorized representative, of the restrictions on the use and disclosure of the returns and return information, the applicable damages remedy under section 7431

of the Internal Revenue Code, and that unauthorized disclosure of information provided by the Internal Revenue Service under this paragraph (d)(3) is also a violation of this part.

(4) *Protective measures*—(i) *Mandatory protective order.* If redaction of names, addresses, and other identifying information of third party taxpayers may still permit indirect identification of any third party taxpayer, the Administrative Law Judge will issue a protective order to ensure that the identifying information is available to the parties and the Administrative Law Judge for purposes of the proceeding, but is not disclosed to, or open to inspection by, the public.

(ii) *Authorized orders.* (A) Upon motion by a party or any other affected person, and for good cause shown, the Administrative Law Judge may make any order which justice requires to protect any person in the event disclosure of information is prohibited by law, privileged, confidential, or sensitive in some other way, including, but not limited to, one or more of the following—

(*1*) That disclosure of information be made only on specified terms and conditions, including a designation of the time or place;

(*2*) That a trade secret or other information not be disclosed, or be disclosed only in a designated way.

(iii) *Denials.* If a motion for a protective order is denied in whole or in part, the Administrative Law Judge may, on such terms or conditions as the Administrative Law Judge deems just, order any party or person to comply with, or respond in accordance with, the procedure involved.

(iv) *Public inspection of documents.* The Secretary of the Treasury, or delegate, shall ensure that all names, addresses or other identifying details of third party taxpayers are redacted and replaced with the code assigned to the corresponding taxpayer in all documents prior to public inspection of such documents.

* * * * *

(g) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 31. Newly designated §10.73 is amended by:

1. Redesignating paragraphs (c), (d), and (e) as paragraphs (d), (e), and (f), respectively.

2. Revising paragraph (b) and newly designated paragraph (d).

3. Adding new paragraphs (c) and (g).

The revisions and additions read as follows:

§10.73 Evidence.

* * * * *

(b) *Depositions.* The deposition of any witness taken pursuant to §10.71 may be admitted into evidence in any proceeding instituted under §10.60.

(c) *Requests for admission.* Any matter admitted in response to a request for admission under §10.71 is conclusively established unless the Administrative Law Judge on motion permits withdrawal or modification of the admission. Any admission made by a party is for the purposes of the pending action only and is not an admission by a party for any other purpose, nor may it be used against a party in any other proceeding.

(d) *Proof of documents.* Official documents, records, and papers of the Internal Revenue Service and the Office of Professional Responsibility are admissible in evidence without the production of an officer or employee to authenticate them. Any documents, records, and papers may be evidenced by a copy attested to or identified by an officer or employee of the Internal Revenue Service or the Treasury Department, as the case may be.

* * * * *

(g) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 32. Section 10.76 is revised to read as follows:

§10.76 Decision of Administrative Law Judge.

(a) *In general*— (1) *Hearings.* Within 180 days after the conclusion of a hearing and the receipt of any proposed findings and conclusions timely submitted by the parties, the Administrative Law Judge should enter a decision in the case. The decision must include a statement of findings and conclusions, as well as the reasons or basis for making such findings and conclusions, and an order of censure, suspension, disbarment, monetary penalty, disqualification, or dismissal of the complaint.

(2) *Summary adjudication.* In the event that a motion for summary adjudication is filed, the Administrative Law Judge should rule on the motion for summary adjudication within 60 days after the party in opposition files a written response, or if no written response is filed, within 90 days after the motion for summary adjudication is filed. A decision shall thereafter be rendered if the pleadings, depositions, admissions, and any other admissible evidence show that there is no genuine issue of material fact and that a decision may be rendered as a matter of law. The decision must include a statement of conclusions, as well as the reasons or basis for making such conclusions, and an order of censure, suspension, disbarment, monetary penalty, disqualification, or dismissal of the complaint.

(3) *Returns and return information.* In the decision, the Administrative Law Judge should use the code assigned to third party taxpayers (described in §10.72(d)).

(b) *Standard of proof.* If the sanction is censure or a suspension of less than six months' duration, the Administrative Law Judge, in rendering findings and conclusions, will consider an allegation of fact to be proven if it is established by the party who is alleging the fact by a preponderance of the evidence in the record. If the sanction is a monetary penalty, disbarment or a suspension of six months or longer duration, an allegation of fact that is necessary for a finding against the practitioner must be proven by clear and convincing evidence in the record. An allegation of fact that is necessary for a finding of disqualification against an appraiser must be proven by clear and convincing evidence in the record.

(c) *Copy of decision.* The Administrative Law Judge will provide the decision to the Director of the Office of Professional Responsibility, with a copy to the Director's authorized representative, and a copy of the decision to the respondent or the respondent's authorized representative.

(d) *When final.* In the absence of an appeal to the Secretary of the Treasury or delegate, the decision of the Administrative Law Judge will, without further proceedings, become the decision of the agency 30 days after the date of the Administrative Law Judge's decision.

(e) *Effective/applicability date.* This section is applicable to proceedings initiated on or after September 26, 2007.

Par. 33. Section 10.77 is revised to read as follows:

§10.77 Appeal of decision of Administrative Law Judge.

(a) *Appeal.* Any party to the proceeding under this subpart D may file an appeal of the decision of the Administrative Law Judge with the Secretary of the Treasury, or delegate. The appeal must include a brief that states exceptions to the decision of the Administrative Law Judge and supporting reasons for such exceptions.

(b) *Time and place for filing of appeal.* The appeal and brief must be filed, in duplicate, with the Director of the Office of Professional Responsibility within 30 days of the date that the decision of the Administrative Law Judge is served on the parties. The Director of the Office of Professional Responsibility will immediately furnish a copy of the appeal to the Secretary of the Treasury or delegate who decides appeals. A copy of the appeal for review must be sent to any non-appealing party. If the Director of the Office of Professional Responsibility files an appeal, he or she will provide a copy of the appeal and certify to the respondent that the appeal has been filed.

(c) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 34. Section 10.78 is revised to read as follows:

§10.78 Decision on review.

(a) *Decision on review.* On appeal from or review of the decision of the Administrative Law Judge, the Secretary of the Treasury, or delegate, will make the agency decision. The Secretary of the Treasury, or delegate, should make the agency decision within 180 days after receipt of the appeal.

(b) *Standard of review.* The decision of the Administrative Law Judge will not be reversed unless the appellant establishes that the decision is clearly erroneous in light of the evidence in the record and applicable law. Issues that are exclusively matters of law will be reviewed *de novo*. In the event that the Secretary of the Treasury, or delegate, determines that there are unresolved issues raised by the record, the case may be remanded to the Administrative Law Judge to elicit additional testimony or evidence.

(c) *Copy of decision on review.* The Secretary of the Treasury, or delegate, will provide copies of the agency decision to the Director of the Office of Professional Responsibility and the respondent or the respondent's authorized representative.

(d) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 35. Section 10.82 is amended by:

1. Revising the section heading and paragraph (b).

2. Adding paragraph (h).

The revisions and addition read as follows:

§10.82 Expedited suspension.

* * * * *

(b) *To whom applicable.* This section applies to any practitioner who, within five years of the date a complaint instituting a proceeding under this section is served:

(1) Has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause (not including failure to pay a professional licensing fee) by any authority or court, agency, body, or board described in §10.51(a)(10).

(2) Has, irrespective of whether an appeal has been taken, been convicted of any crime under title 26 of the United States Code, any crime involving dishonesty or breach of trust, or any felony for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(3) Has violated conditions imposed on the practitioner pursuant to §10.79(d).

(4) Has been sanctioned by a court of competent jurisdiction, whether in a civil or criminal proceeding (including suits for injunctive relief), relating to any taxpayer's tax liability or relating to the practitioner's own tax liability, for—

(i) Instituting or maintaining proceedings primarily for delay;

(ii) Advancing frivolous or groundless arguments; or

(iii) Failing to pursue available administrative remedies.

* * * * *

(h) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 36. Section 10.90 is revised to read as follows:

§10.90 Records.

(a) *Roster.* The Director of the Office of Professional Responsibility will maintain, and may make available for public inspection in the time and manner prescribed by the Secretary of the Treasury, or delegate, rosters of—

(1) Enrolled agents, including individuals—

(i) Granted active enrollment to practice;

(ii) Whose enrollment has been placed in inactive status for failure to meet the requirements for renewal of enrollment;

(iii) Whose enrollment has been placed in inactive retirement status; and

(iv) Whose offer of consent to resign from enrollment has been accepted by the Director of the Office of Professional Responsibility under §10.61;

(2) Individuals (and employers, firms or other entities, if applicable) censured, suspended, or disbarred from practice before the Internal Revenue Service or upon whom a monetary penalty was imposed;

(3) Disqualified appraisers; and

(4) Enrolled retirement plan agents, including individuals—

(i) Granted active enrollment to practice;

(ii) Whose enrollment has been placed in inactive status for failure to meet the requirements for renewal of enrollment;

(iii) Whose enrollment has been placed in inactive retirement status; and

(iv) Whose offer of consent to resign from enrollment has been accepted by the Director of the Office of Professional Responsibility under §10.61.

(b) *Other records.* Other records of the Director of the Office of Professional Responsibility may be disclosed upon specific request, in accordance with the applicable law.

(b) *Effective/applicability date.* This section is applicable on September 26, 2007.

Par. 37. Section 10.91 is revised to read as follows:

§10.91 Saving provision.

Any proceeding instituted under this part prior to July 26, 2002, for which a final decision has not been reached or for which judicial review is still available will not be affected by these revisions. Any proceeding under this part based on conduct engaged in prior to September 26, 2007, which is instituted after that date, will apply subpart D and E or this part as revised, but the conduct engaged in prior to the effective date of these revisions will be judged by the regulations in effect at the time the conduct occurred.

Linda E. Stiff,
Acting Deputy Commissioner for Services and Enforcement.

Approved September 19, 2007.

Robert Hoyt,
General Counsel,
Office of the Secretary.

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54540)

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 408A.—Roth IRAs

The Service provides inflation adjustments to the applicable dollar amounts used to calculate the amount by which a taxpayer must reduce the maximum amount allowed as contributions to Roth IRAs for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 419.—Treatment of Funded Welfare Benefit Plans

26 CFR § 1.419–1T: Treatment of welfare benefit funds.
(Also, §§ 264, 7805; § 301.7805–1.)

Employer's deduction for contributions; limitation on employer's deduction; welfare benefit funds. This ruling discusses whether an employer's deductions for contributions to a welfare benefit fund under section 419 of the Code are "qualified direct costs" with respect to premiums paid by a welfare benefit fund on cash value life insurance policies.

Rev. Rul. 2007–65

ISSUES

(1) For purposes of determining the limitations on an employer's deduction for contributions to a welfare benefit fund under §§ 419 and 419A of the Internal Revenue Code (the "Code"), are premiums on cash value life insurance policies paid by the fund included in the fund's qualified direct cost if the benefit provided through the fund is life insurance coverage?

(2) For purposes of determining the limitations on an employer's deduction for contributions to a welfare benefit fund under §§ 419 and 419A, are premiums on cash value life insurance policies paid by the fund included in the fund's qualified direct cost if the benefit provided through the fund is other than life insurance coverage?

FACTS

Situation 1. Employer C maintains an employer-financed life insurance plan for the benefit of its employees. The life insurance provided to C's employees under the plan satisfies the definition of group-term life insurance for purposes of § 79 and is provided through a taxable trust. The plan does not provide permanent benefits within the meaning of § 1.79–0 of the Income Tax Regulations. The plan, which is not maintained pursuant to a collective bargaining agreement, provides that C will provide a stated amount of life insurance coverage for each employee while the employee is actively employed by C. No other benefits are provided to the employees under the plan or from the trust. The trustee has obtained a cash value life insurance policy on the life of each employee, where the amount of the death benefit under each policy equals the amount of the death benefit payable under the plan to the employee's beneficiary and the death benefit proceeds under each policy are payable to the beneficiary designated by the employee. The trust has retained all other policy rights. During the year, C contributes to the trust an amount equal to the aggregate premiums due on the life insurance policies payable by the trustee. The trust has no administrative expenses and no after-tax income (within the meaning of § 419(c)(4)) for the year. The taxable year for both C and the trust is the calendar year, and C uses the accrual method of accounting.

Situation 2. The facts are the same as in *Situation 1* except that, instead of group-term life insurance, the plan provides disability benefits to C's employees if they become disabled while they are actively employed by C. The trust is the owner and the named beneficiary of the life insurance policies held by the trust, which are intended to accumulate value to pay the disability benefits. The employees have no interest in the life insurance policies. During the taxable year, the trust distributed $x of disability benefits with respect to claims incurred during the year (and there were no benefits paid during the year with respect to any claims incurred in prior years).

LAW

Section 419 prescribes limits on the amount of deductions for contributions paid or accrued by an employer to a welfare benefit fund. The term "welfare benefit fund" is defined in § 419(e)(1) to mean any fund that is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries. Section 419(e)(2) defines "welfare benefit" as any benefit other than a benefit with respect to which § 83(h), § 404 (determined without regard to § 404(b)(2)), or § 404A applies. Under § 419(e)(3), a "fund" is any organization described in § 501(c)(7), (9), (17) or (20); any trust, corporation, or other organization not exempt from tax imposed by chapter 1, subtitle A of the Code; or, to the extent provided in regulations, any account held for an employer by

any person (other than amounts described in § 419(e)(4)).

Under § 419(a) and (b), an employer's contributions to a welfare benefit fund are deductible in the taxable year in which paid but only if they would otherwise be deductible under Chapter 1 of the Code, and the amount of the deduction is limited to the welfare benefit fund's qualified cost for the taxable year. Pursuant to § 419(d), if the amount of the contributions paid by the employer during any taxable year to a welfare benefit fund exceeds this deduction limit, the excess is treated as an amount paid by the employer to the fund during the succeeding taxable year.

The term "qualified cost" is defined in § 419(c)(1) to generally mean, with respect to any taxable year, the sum of (i) the qualified direct cost for that taxable year, and (ii) any addition to a qualified asset account for the taxable year (but only to the extent the addition does not exceed the limit on the additions to the account under § 419A(b)). Under § 419(c)(2), the fund's qualified cost must be reduced by the fund's after-tax income for the taxable year (as defined in § 419(c)(4)). Under § 419(c)(5), no item may be taken into account more than once in determining the qualified cost of any welfare benefit fund.

The term "qualified direct cost" is generally defined in § 419(c)(3)(A) to mean, with respect to any taxable year, the aggregate amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the year if (i) such benefits were provided directly by the employer, and (ii) the employer used the cash receipts and disbursements method of accounting. Under § 419(c)(3)(B), a benefit is treated for this purpose as provided when that benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for a provision of chapter 1 of the Code excluding the benefit from gross income).

The term "qualified asset account" is defined in § 419A(a) to mean any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, supplemental unemployment compensation benefits or severance pay benefits, or life insurance benefits. Pursuant to § 419A(b), no additions to any qualified asset account may be taken into account under § 419(c)(1)(B) to the extent that the addition would result in the amount in the account exceeding the account limit specified in § 419A(c).

Section 419A(c)(1) provides that the account limit for any qualified asset account for any taxable year is generally the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for benefits referred to in § 419A(a), and administrative costs with respect to those claims. Section 419A(c)(2) allows an additional limited reserve for certain post-retirement medical and post-retirement life insurance benefits to be provided to covered employees. Section 419A(c)(3) through (c)(6) and § 419A(d) and (e) specify additional rules with regard to the account limit under §419A(c).

Under Q&A–6(a) of § 1.419–1T of the Temporary Income Tax Regulations, the qualified direct cost of a welfare benefit fund for any taxable year of the fund is the aggregate amount that would have been allowable as a deduction to the employer for benefits provided by the fund during the year (including insurance coverage for the year) if (i) those benefits were provided directly by the employer and (ii) the employer used the cash receipts and disbursements method of accounting and had the same taxable year as the fund. In this regard, a benefit is treated as provided when the benefit would be includible in the gross income of the employee if provided directly by the employer (or would be so includible but for a provision excluding it from gross income). Under Q&A–6(c) of § 1.419–1T, the qualified direct cost of a welfare benefit fund does not include expenditures by the fund that would not have been deductible if they had been made directly by the employer. As an example of such an expenditure, the regulations provide that a fund's purchase of land for an employee recreational facility will not be treated as a qualified direct cost, noting that the purchase would not have been deductible under § 263 if made directly by the employer. Q&A–6(c) of § 1.419–1T also refers to §§ 264 and 274.

In its explanation of "qualified direct cost," the legislative history of § 419 states that the rules in other Code sections that generally limit deductions if an employer provides the plan benefits directly are "passed through" to limit deductions with respect to fund contributions. An example of this limitation is given for fund expenditures for insurance that would not have been deductible under § 264 if made directly by the employer. "[T]hus, no deductions are available to the employer with respect to such expenditures." *H.R. Rep. No. 432*, 98th Cong., 2d Sess. at 1277–78 (1984).

Section 264(a)(1) provides that no deduction is allowable for premiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.

Pursuant to § 61(a)(1), except as otherwise provided, gross income means all income from whatever source derived, including compensation for services, including fees, commissions, fringe benefits, and similar items. Gross income includes the value of any economic benefit conferred on an employee by his or her employer, whatever the form or mode by which it is effected. *Commissioner v. Smith*, 324 U.S. 177, 181 (1945), 1945 C.B. 49, 51. Accordingly, if an employer pays premiums on a life insurance policy that it owns and the death benefits are payable to an employee's beneficiaries, the value of the economic benefits provided to the employee, including the cost of current life insurance protection, is includible in the employee's gross income annually. This is true even if the employee only has rights with respect to all or a portion of the death proceeds and the employer retains all other rights and benefits under the policy. *See, e.g., Genshaft v. Commissioner*, 64 T.C. 282, 290 (1975), acq., 1976–2 C.B. 2; *Frost v. Commissioner*, 52 T.C. 89, 96 (1969). Special rules apply under § 1.61–22 for a split-dollar life insurance arrangement, as that term is defined in § 1.61–22(b), that is entered into or materially modified after September 17, 2003.

Section 79 generally provides an exclusion from an employee's gross income for the cost of group-term life insurance on the employee's life provided under a policy carried directly or indirectly by his or her employer (or employers), but only to the extent that the cost does not exceed the cost of $50,000 of coverage.

ANALYSIS

In *Situation 1*, the trust is a welfare benefit fund within the meaning of § 419(e). The qualified direct cost of the trust for the year involved is the aggregate amount (including administrative expenses) that would have been allowable as a deduction to C for the benefit provided by the trust during the year (current life insurance coverage) if the life insurance coverage had been provided directly by C, and if C had used the cash receipts and disbursements method of accounting. Under § 419(c)(3)(B), the life insurance coverage is treated as provided when it would be includible in the gross income of the employee if provided directly by the employer (or would be so includible absent the exclusion from gross income provided under § 79). Absent the § 79 exclusion, the cost of the current life insurance protection provided to C's employees for part or all of a year is includible in the employees' incomes for that year.

If C had provided the current life insurance coverage directly (that is, if C had not interposed a trust to obtain and hold the cash value life insurance policies, but instead had held the policies and paid the premiums itself), C would have retained ownership rights in each of the policies, including the right to withdraw funds from a policy's cash value or to surrender the policy for cash. As a result, C would have been, directly or indirectly, a beneficiary under the policies. Thus, § 264(a) would have precluded any deduction by C with respect to the premium payments if C had owned the policies directly. *See* Rev. Rul. 70–148, 1970–1 C.B. 60.

Under § 419(c)(3) and Q&A–6(c) of § 1.419–1T, the qualified direct cost of a welfare benefit fund does not include expenditures by the fund that would not have been deductible if they had been made directly by the employer. Accordingly, the trust's qualified direct cost for the taxable year in *Situation 1* does not include any amounts for premiums on the cash value life insurance policies paid by the trust. Further, because all the benefits provided by the plan are fully insured, no amounts are reasonably and actuarially necessary to fund claims incurred but unpaid for purposes of the account limit under § 419A(c)(1). Thus, the qualified cost is zero and no portion of C's contributions is deductible under § 419 for the taxable year.

The conclusions for *Situation 1* are the same regardless of whether the plan benefits are provided through a taxable trust, an exempt VEBA described in § 501(c)(9), or any other type of welfare benefit fund as defined in § 419(e). Also, the conclusions for *Situation 1* are the same regardless of whether the death proceeds are payable from the insurance company directly to the beneficiaries designated by the employees, or are payable to the trust or plan for the benefit of the employees' beneficiaries. Additionally, the conclusions for *Situation 1* are the same regardless of the number or amount of premiums, and regardless of the type of life insurance policy. Thus, the conclusions would apply, for example, to a variable policy, to a policy with level premiums payable to age 65, or to any other life insurance policy, if the trust is directly or indirectly a beneficiary under the policy. Further, the same rule applies if the employer, rather than the welfare benefit fund, is directly or indirectly a beneficiary under the policy.

The conclusion for *Situation 1* that no deduction is allowable with respect to the premium amounts would be the same if the plan were an arrangement subject to the regulations for split-dollar life insurance arrangements. See § 1.61–22 for the rules for split-dollar life insurance arrangements, including § 1.61–22(c)(1)(iii)(C) (providing that the employer is treated as the owner of a life insurance policy if the owner is a welfare benefit fund within the meaning of § 419(e)(1)); and § 1.61–22(f)(2)(ii) (concerning the nondeductibility of premium amounts by the employer under a split-dollar arrangement).

In *Situation 2*, the qualified direct cost of the trust for the taxable year is the aggregate amount (including administrative expenses) that would have been allowable as a deduction to C for the uninsured disability benefits provided by the trust during the year if the disability benefits had been provided directly by C, and if C had used the cash receipts and disbursements method of accounting. In this regard, the disability benefits are treated as provided when they would be includible in the gross income of the employees if provided directly by C (or would be includible in income absent a provision of the Code excluding them from income).

Under the facts of *Situation 2*, the trust paid $x during the year with respect to disability benefits incurred during the year (and no benefits were paid with respect to any claims incurred in prior years). These disability benefits are includible in an employee's income under § 105(a) when the benefits are received by the employee. If Employer C had used the cash receipts and disbursements method of accounting, and if C had provided the uninsured disability benefits directly (that is, if C had not interposed a trust to provide the disability benefits, but instead had paid the disability benefits to the employees itself), C would have been allowed a deduction for the year for the $x actually paid during the year. Thus, the fund's qualified direct cost for the year with respect to the benefits under the plan is $x. Furthermore, if C had purchased the cash value life insurance policies directly to accumulate assets to pay the uninsured disability benefits, § 264(a) would have precluded any deduction by C with respect to the premium payments because C would have retained ownership rights in the policies. Thus, the premium amounts paid by the trust are not included in the fund's qualified direct cost under § 419(c)(3). However, some of C's contribution amounts may be deductible as qualified cost in the taxable year as an addition to a qualified asset account for disability claims incurred but unpaid as of the close of the taxable year, but only if the amounts are otherwise deductible, and only to the extent they are reasonably and actuarially necessary to fund incurred but unpaid claims and satisfy the requirements of § 419A(c)(4) and (c)(5).

The conclusions for *Situation 2* are the same regardless of whether the plan benefits are provided through a taxable trust, an exempt VEBA described in § 501(c)(9), or any other type of welfare benefit fund as defined in § 419(e). Additionally, the conclusions for *Situation 2* are the same regardless of the type of assets, if any, purchased by the trustee to fund the disability benefits (other than the purchase of disability insurance to the extent the premiums paid for the insurance would otherwise be deductible by the employer if the employer had purchased it directly and the employer used the cash receipts and disbursement method of accounting).

The conclusion for *Situation 2* that the qualified direct cost does not include any amounts paid for life insurance premiums would be the same if the benefit or benefits provided under the plan were uninsured medical or severance benefits, or any other type of uninsured benefit.

HOLDINGS

(1) For purposes of determining the limitations on an employer's deduction for contributions to a welfare benefit fund under §§ 419 and 419A, if the benefit provided through the fund is life insurance coverage, premiums paid on cash value life insurance policies by the fund are not included in the fund's qualified direct cost whenever the fund is directly or indirectly a beneficiary under the policy within the meaning of § 264(a).

(2) For purposes of determining the limitations on an employer's deduction for contributions to a welfare benefit fund under §§ 419 and 419A, if the benefit provided through the fund is other than life insurance coverage, premiums paid on cash value life insurance policies by the fund are not included in the fund's qualified direct cost whenever the fund is directly or indirectly a beneficiary under the policy within the meaning of § 264(a). However, the fund's qualified direct cost includes amounts paid as welfare benefits by the fund during the taxable year for claims incurred during the year.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in § 7805(b)(8) and § 301.7805–1 of the Procedure and Administration Regulations, with respect to Holding (1) the Commissioner has determined that for any taxable year of an employer ending before November 5, 2007, if a deduction is otherwise allowable, then to the extent set forth in the following paragraph, a deduction for contributions to a welfare benefit fund under an arrangement that is not subject to the regulations applicable to split-dollar life insurance arrangements will not be disallowed under § 419(b) and (c)(3) merely because the deduction would have been disallowed under § 264 had the employer provided the benefits directly.

In the case of an employer with a taxable year that is the calendar year, the amount of the deduction that will not be disallowed for a taxable year is the portion of the amounts that are otherwise disallowed under this revenue ruling that were reported (or would have been reported but for the exclusion under § 79) by the employer as the cost of insurance on each employee's Forms W–2 (or Forms 1099) for that year. In the case of an employer with a taxable year other than the calendar year, the deduction that will not be disallowed for a taxable year is the reported (and excluded) amounts described in the previous sentence that are properly allocable to the employer's taxable year. In either case, these amounts are to be determined without regard to any amendment to any Form W–2 or Form 1099 made after October 17, 2007.

REFERENCE TO LISTED TRANSACTIONS NOTICE

Some of the arrangements described in this revenue ruling and substantially similar arrangements (as well as certain other arrangements utilizing cash value life insurance policies for which an employer has deducted amounts as contributions to a welfare benefit fund) may be transactions that have been designated as listed transactions. See Notice 2007–83, this Bulletin. If a transaction is designated as a listed transaction, affected persons may be subject to additional penalties and disclosure responsibilities.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Betty J. Clary of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities) and Larry Isaacs of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact Betty J. Clary at (202) 622–6080 (not a toll-free call) or Larry Isaacs at *RetirementPlanQuestions@irs.gov*.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 512.—Unrelated Business Taxable Income

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 513.—Unrelated Trade or Business

The Service provides an inflation adjustment to the maximum cost of a "low cost article" for taxable years beginning in 2008. Funds raised through a charity's distribution of "low cost articles" will not be treated as unrelated business income to the charity. See Rev. Proc. 2007-66, page 970.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 685.—Treatment of Funeral Trusts

The Service provides an inflation adjustment to the maximum amount of contributions that may be made

to a qualified funeral trust for contracts entered in calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 877.—Expatriation to Avoid Tax

The Service provides an inflation adjustment to the amount used for calendar year 2008 to determine whether an individual's loss of United States citizenship had the avoidance of United States tax as one of its principal purposes. See Rev. Proc. 2007-66, page 970.

Section 911.—Citizens or Residents of the United States Living Abroad

The Service provides an inflation adjustment to the amount of foreign earned income that may be excluded from gross income for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 995.—Taxation of DISC Income to Shareholders

2007 base period T-bill rate. The "base period T-bill rate" for the period ending September 30, 2007, is published as required by section 995(f) of the Code.

Rev. Rul. 2007-64

Section 995(f)(1) of the Internal Revenue Code provides that a shareholder of a DISC shall pay interest each taxable year in an amount equal to the product of the shareholder's DISC-related deferred tax liability for the year and the "base period T-bill rate." Under section 995(f)(4), the base period T-bill rate is the annual rate of interest determined by the Secretary to be equivalent to the average of the 1-year constant maturity Treasury yields, as published by the Board of Governors of the Federal Reserve System, for the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder. The base period T-bill rate for the period ending September 30, 2007 is 4.87 percent.

Pursuant to section 6622 of the Code, interest must be compounded daily. The table below provides factors for compounding the base period T-bill rate daily for any number of days in the shareholder's taxable year (including a 52–53 week accounting period) for the 2007 base period T-bill rate. To compute the amount of the interest charge for the shareholder's taxable year, multiply the amount of the shareholder's DISC-related deferred tax liability (as defined in section 995(f)(2)) for that year by the base period T-bill rate factor corresponding to the number of days in the shareholder's taxable year for which the interest charge is being computed. Generally, one would use the factor for 365 days. One would use a different factor only if the shareholder's taxable year for which the interest charge being determined is a short taxable year, if the shareholder uses the 52–53 week taxable year, or if the shareholder's taxable year is a leap year.

For the base period T-bill rates for the periods ending in prior years, see Rev. Rul. 2006–54, 2006–45 I.R.B. 834, Rev. Rul. 2005–70, 2005–2 C.B. 919, Rev. Rul. 2004–99, 2004–2 C.B. 720, Rev. Rul. 2003–111, 2003–2 C.B. 1009, Rev. Rul. 2002–68, 2002–2 C.B. 808, Rev. Rul. 2001–56, 2001–2 C.B. 500, and Rev. Rul. 2000–52, 2000–2 C.B. 516.

DRAFTING INFORMATION

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2007 ANNUAL RATE, COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
1	.000133425
2	.000266867
3	.000400327
4	.000533805
5	.000667301
6	.000800815
7	.000934347
8	.001067896
9	.001201463
10	.001335048
11	.001468651
12	.001602271
13	.001735910
14	.001869566
15	.002003240
16	.002136932
17	.002270642
18	.002404370
19	.002538115
20	.002671878
21	.002805659
22	.002939458
23	.003073275
24	.003207110
25	.003340963
26	.003474833
27	.003608721
28	.003742627
29	.003876551
30	.004010493
31	.004144453
32	.004278431
33	.004412426
34	.004546440
35	.004680471
36	.004814520
37	.004948587
38	.005082672
39	.005216775
40	.005350895

2007 ANNUAL RATE, COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
41	.005485034
42	.005619191
43	.005753365
44	.005887557
45	.006021767
46	.006155996
47	.006290242
48	.006424506
49	.006558787
50	.006693087
51	.006827405
52	.006961740
53	.007096094
54	.007230465
55	.007364855
56	.007499262
57	.007633687
58	.007768130
59	.007902592
60	.008037071
61	.008171568
62	.008306083
63	.008440616
64	.008575166
65	.008709735
66	.008844322
67	.008978927
68	.009113549
69	.009248190
70	.009382849
71	.009517525
72	.009652220
73	.009786932
74	.009921663
75	.010056411
76	.010191177
77	.010325962
78	.010460764
79	.010595585
80	.010730423

2007 ANNUAL RATE, COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
81	.010865279
82	.011000154
83	.011135046
84	.011269956
85	.011404885
86	.011539831
87	.011674795
88	.011809778
89	.011944778
90	.012079797
91	.012214833
92	.012349887
93	.012484960
94	.012620050
95	.012755159
96	.012890285
97	.013025430
98	.013160592
99	.013295773
100	.013430972
101	.013566188
102	.013701423
103	.013836676
104	.013971947
105	.014107236
106	.014242542
107	.014377867
108	.014513210
109	.014648571
110	.014783951
111	.014919348
112	.015054763
113	.015190196
114	.015325648
115	.015461117
116	.015596605
117	.015732110
118	.015867634
119	.016003176
120	.016138736

2007 ANNUAL RATE, COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
121	.016274314
122	.016409910
123	.016545524
124	.016681156
125	.016816807
126	.016952475
127	.017088162
128	.017223866
129	.017359589
130	.017495330
131	.017631089
132	.017766866
133	.017902661
134	.018038474
135	.018174306
136	.018310155
137	.018446023
138	.018581909
139	.018717813
140	.018853735
141	.018989675
142	.019125633
143	.019261610
144	.019397605
145	.019533617
146	.019669648
147	.019805697
148	.019941765
149	.020077850
150	.020213953
151	.020350075
152	.020486215
153	.020622373
154	.020758549
155	.020894744
156	.021030956
157	.021167187
158	.021303436
159	.021439703
160	.021575988

2007 ANNUAL RATE,
COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
161	.021712291
162	.021848613
163	.021984953
164	.022121311
165	.022257687
166	.022394081
167	.022530494
168	.022666925
169	.022803374
170	.022939841
171	.023076326
172	.023212830
173	.023349352
174	.023485892
175	.023622450
176	.023759027
177	.023895621
178	.024032234
179	.024168865
180	.024305515
181	.024442182
182	.024578868
183	.024715572
184	.024852295
185	.024989035
186	.025125794
187	.025262571
188	.025399366
189	.025536180
190	.025673012
191	.025809862
192	.025946730
193	.026083617
194	.026220522
195	.026357445
196	.026494386
197	.026631346
198	.026768324
199	.026905320
200	.027042334

2007 ANNUAL RATE,
COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
201	.027179367
202	.027316418
203	.027453487
204	.027590575
205	.027727681
206	.027864805
207	.028001948
208	.028139109
209	.028276288
210	.028413485
211	.028550701
212	.028687935
213	.028825187
214	.028962458
215	.029099747
216	.029237054
217	.029374380
218	.029511724
219	.029649086
220	.029786466
221	.029923865
222	.030061283
223	.030198718
224	.030336172
225	.030473644
226	.030611135
227	.030748644
228	.030886171
229	.031023717
230	.031161281
231	.031298863
232	.031436464
233	.031574083
234	.031711720
235	.031849376
236	.031987050
237	.032124743
238	.032262454
239	.032400183
240	.032537931

2007 ANNUAL RATE,
COMPOUNDED DAILY

4.87 PERCENT

DAYS	FACTOR
241	.032675697
242	.032813481
243	.032951284
244	.033089105
245	.033226944
246	.033364802
247	.033502679
248	.033640573
249	.033778487
250	.033916418
251	.034054368
252	.034192336
253	.034330323
254	.034468328
255	.034606352
256	.034744394
257	.034882454
258	.035020533
259	.035158630
260	.035296746
261	.035434880
262	.035573033
263	.035711204
264	.035849393
265	.035987601
266	.036125827
267	.036264072
268	.036402335
269	.036540617
270	.036678917
271	.036817235
272	.036955572
273	.037093928
274	.037232302
275	.037370694
276	.037509105
277	.037647534
278	.037785982
279	.037924448
280	.038062933

2007 ANNUAL RATE, COMPOUNDED DAILY 4.87 PERCENT	
DAYS	FACTOR
281	.038201436
282	.038339958
283	.038478498
284	.038617057
285	.038755634
286	.038894229
287	.039032844
288	.039171476
289	.039310127
290	.039448797
291	.039587485
292	.039726192
293	.039864917
294	.040003660
295	.040142422
296	.040281203
297	.040420002
298	.040558820
299	.040697656
300	.040836511
301	.040975384
302	.041114276
303	.041253186
304	.041392115
305	.041531062
306	.041670028
307	.041809013
308	.041948016
309	.042087037
310	.042226077
311	.042365136
312	.042504213
313	.042643309
314	.042782423
315	.042921556
316	.043060708
317	.043199878
318	.043339066
319	.043478274
320	.043617499

2007 ANNUAL RATE, COMPOUNDED DAILY 4.87 PERCENT	
DAYS	FACTOR
321	.043756744
322	.043896006
323	.044035288
324	.044174588
325	.044313907
326	.044453244
327	.044592600
328	.044731974
329	.044871367
330	.045010779
331	.045150209
332	.045289658
333	.045429125
334	.045568611
335	.045708116
336	.045847639
337	.045987181
338	.046126741
339	.046266320
340	.046405918
341	.046545535
342	.046685170
343	.046824823
344	.046964495
345	.047104186
346	.047243896
347	.047383624
348	.047523371
349	.047663136
350	.047802920
351	.047942723
352	.048082544
353	.048222384
354	.048362243
355	.048502121
356	.048642017
357	.048781931
358	.048921865
359	.049061817
360	.049201787

2007 ANNUAL RATE, COMPOUNDED DAILY 4.87 PERCENT	
DAYS	FACTOR
361	.049341777
362	.049481785
363	.049621812
364	.049761857
365	.049901921
366	.050042004
367	.050182105
368	.050322226
369	.050462365
370	.050602522
371	.050742698

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for November 2007.

Rev. Rul. 2007–66

This revenue ruling provides various prescribed rates for federal income tax purposes for November 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an

interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2007–66 TABLE 1

Applicable Federal Rates (AFR) for November 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.11%	4.07%	4.05%	4.04%
110% AFR	4.53%	4.48%	4.46%	4.44%
120% AFR	4.94%	4.88%	4.85%	4.83%
130% AFR	5.36%	5.29%	5.26%	5.23%
Mid-term				
AFR	4.39%	4.34%	4.32%	4.30%
110% AFR	4.83%	4.77%	4.74%	4.72%
120% AFR	5.28%	5.21%	5.18%	5.15%
130% AFR	5.72%	5.64%	5.60%	5.57%
150% AFR	6.62%	6.51%	6.46%	6.42%
175% AFR	7.74%	7.60%	7.53%	7.48%
Long-term				
AFR	4.89%	4.83%	4.80%	4.78%
110% AFR	5.38%	5.31%	5.28%	5.25%
120% AFR	5.88%	5.80%	5.76%	5.73%
130% AFR	6.38%	6.28%	6.23%	6.20%

REV. RUL. 2007–66 TABLE 2

Adjusted AFR for November 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.40%	3.37%	3.36%	3.35%
Mid-term adjusted AFR	3.61%	3.58%	3.56%	3.55%
Long-term adjusted AFR	4.30%	4.25%	4.23%	4.21%

REV. RUL. 2007–66 TABLE 3

Rates Under Section 382 for November 2007

Adjusted federal long-term rate for the current month	4.30%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.49%

REV. RUL. 2007–66 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for November 2007

Appropriate percentage for the 70% present value low-income housing credit	8.08%
Appropriate percentage for the 30% present value low-income housing credit	3.46%

REV. RUL. 2007–66 TABLE 5

Rate Under Section 7520 for November 2007

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 2032A.—Valuation of Certain Farm, etc., Real Property

The Service provides an inflation adjustment to the maximum amount by which the value of certain farm and other qualified real property included in a decedent's gross estate may be decreased for purposes of valuing the estate of a decedent dying in calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 2503.—Taxable Gifts

The Service provides an inflation adjustment to the amount of gifts that may be made to a person in a calendar year without including the amount in taxable gifts for calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 2523.—Gift to Spouse

The Service provides an inflation adjustment to the amount of gifts that may be made in a calendar year to a spouse who is not a citizen of the United States without including the amount in taxable gifts for calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 4161.—Imposition of Tax

The Service provides an inflation adjustment to the amount of excise tax imposed for calendar year 2008 on the first sale by a manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows. See Rev. Proc. 2007-66, page 970.

Section 6033.—Returns by Exempt Organizations

The Service provides an inflation adjustment to the amount of dues certain exempt organizations with nondeductible lobbying expenditures can charge and still be excepted from reporting requirements for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 6039F.—Notice of Large Gifts Received From Foreign Persons

The Service provides an inflation adjustment to the amount of gifts received, in a taxable year from foreign persons, that triggers a reporting requirement for a United States person for taxable years beginning in 2008. See Rev. Proc. 2007-66, page 970.

Section 6323.—Validity and Priority Against Certain Persons

The Service provides inflation adjustments for calendar year 2008 to (1) the maximum amount of a casual sale of personal property below which a federal tax lien will not be valid against a purchaser of the property and (2) the maximum amount of a contract for the repair or improvement of certain residential property at or below which a federal tax lien will not be valid against a mechanic's lienor. See Rev. Proc. 2007-66, page 970.

Section 6334.—Property Exempt From Levy

The Service provides inflation adjustments to the value of certain property exempt from levy (fuel, provisions, furniture, household personal effects, arms for personal use, livestock, poultry, and books and tools of a trade, business, or profession) for calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax

The Service provides an inflation adjustment to the amount used to determine the amount of interest charged on a certain portion of the estate tax payable in installments for the estate of a decedent dying in calendar year 2008. See Rev. Proc. 2007-66, page 970.

Section 7430.—Awarding of Costs and Certain Fees

The Service provides an inflation adjustment to the hourly limit on attorney fees incurred in calendar year 2008 that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty. See Rev. Proc. 2007-66, page 970.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Section 7702B.—Treatment of Qualified Long-Term Care Insurance

The Service provides an inflation adjustment to the stated dollar amount for calendar year 2008 of the *per diem* limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death

of a chronically ill individual. See Rev. Proc. 2007-66, page 970.

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

Whether a holding in Rev. Rul. 2007–65 will be applied retroactively. See Rev. Rul. 2007-65, page 949.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2007. See Rev. Rul. 2007-66, page 956.

Part III. Administrative, Procedural, and Miscellaneous

Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits

Notice 2007–83

The Internal Revenue Service (IRS) and Treasury Department are aware of certain trust arrangements claiming to be welfare benefit funds and involving cash value life insurance policies that are being promoted to and used by taxpayers to improperly claim federal income and employment tax benefits. This notice informs taxpayers and their representatives that the tax benefits claimed for these arrangements are not allowable for federal tax purposes. This notice also alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies certain transactions using trust arrangements involving cash value life insurance policies, and substantially similar transactions, as listed transactions for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice further alerts persons involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Concurrently with this notice, the IRS is publishing Rev. Rul. 2007–65 (concluding that for purposes of deductions allowable to an employer under § 419, a welfare benefit fund's qualified direct cost does not include premium amounts for cash value life insurance policies paid by the fund, whenever the fund is directly or indirectly a beneficiary under the policy within the meaning of § 264(a)), and Notice 2007–84 (describing trust arrangements involving purported welfare benefit funds that, in form, provide post-retirement medical and life insurance benefits to employees on a nondiscriminatory basis but, in operation, result in the owner or owners receiving all or a substantial portion of the post-retirement and other benefits, and all or a substantial portion of any assets distributed from the trust).

BACKGROUND

1. Promoted Arrangements

Trust arrangements utilizing cash value life insurance policies and purporting to provide welfare benefits to active employees are being promoted to small businesses and other closely held businesses as a way to provide cash and other property to the owners of the business on a tax-favored basis. The arrangements are sometimes referred to by persons advocating their use as "single employer plans" and sometimes as "419(e) plans." Those advocates claim that the employers' contributions to the trust are deductible under §§ 419 and 419A as qualified cost, but that there is not a corresponding inclusion in the owner's income.

A promoted trust arrangement may be structured either as a taxable trust or a tax-exempt trust, *i.e.*, a voluntary employees' beneficiary association (VEBA) that has received a determination letter from the IRS that it is described in § 501(c)(9). The plan and the trust documents indicate that the plan provides benefits such as current death benefit protection, self-insured disability benefits, and/or self-insured severance benefits to covered employees (including those employees who are also owners of the business), and that the benefits are payable while the employee is actively employed by the employer. The employer's contributions are often based on premiums charged for cash value life insurance policies. For example, contributions may be based on premiums that would be charged for whole life policies. As a result, the arrangements often require large employer contributions relative to the actual cost of the benefits currently provided under the plan.

Under these arrangements, the trustee uses the employer's contributions to the trust to purchase life insurance policies. The trustee typically purchases cash value life insurance policies on the lives of the employees who are owners of the business (and sometimes other key employees), while purchasing term life insurance policies on the lives of the other employees covered under the plan.

It is anticipated that after a number of years the plan will be terminated and the cash value life insurance policies, cash, or other property held by the trust will be distributed to the employees who are plan participants at the time of the termination. While a small amount may be distributed to employees who are not owners of the business, the timing of the plan termination and the methods used to allocate the remaining assets are structured so that the business owners and other key employees will receive, directly or indirectly, all or a substantial portion of the assets held by the trust.

Those advocating the use of these plans often claim that the employer is allowed a deduction under § 419(c)(3) for its contributions when the trustee uses those contributions to pay premiums on the cash value life insurance policies, while at the same time claiming that nothing is includible in the owner's gross income as a result of the contributions (or, if amounts are includible, they are significantly less than the premiums paid on the cash value life insurance policies). They may also claim that nothing is includible in the income of the business owner or other key employee as a result of the transfer of a cash value life insurance policy from the trust to the employee, asserting that the employee has purchased the policy when, in fact, any amounts the owner or other key employee paid for the policy may be significantly less than the fair market value of the policy. Some of the plans are structured so that the owner or other key employee is the named owner of the life insurance policy from the plan's inception, with the employee assigning all or a portion of the death proceeds to the trust. Advocates of these arrangements may claim that no income inclusion is required because there is no transfer of the policy itself from the trust to the employees.

2. Intent to Challenge Transactions

The IRS intends to challenge the claimed tax benefits for the above-described transactions for various reasons. Depending on the facts and circumstances of a particular arrangement, contributions to a purported welfare benefit fund on behalf of an employee who is a shareholder may properly be characterized as dividend income to the owner, the value of which is includible in the owner's gross income,

and for which amounts are not deductible by the corporation. *See Neonatology Associates v. Commissioner*, 299 F.3d 221 (3d Cir. 2002). Depending on the facts and circumstances of a particular arrangement, the arrangement may properly be characterized as a plan deferring the receipt of compensation for purposes of § 404(a)(5), resulting in the application of the rules under § 404(a)(5) governing the timing of any otherwise available deductions. *See Wellons v. Commissioner*, 31 F.3d 569 (7th Cir. 1994). In addition, an arrangement may properly be characterized as a nonqualified deferred compensation plan for purposes of § 409A. Application of § 409A may result in immediate inclusion of income and additional taxes to the employee, as well as income tax withholding liabilities to the employer. The facts and circumstances of a particular arrangement may result in it coming within the definition of a split-dollar life insurance arrangement, so that the tax consequences to the employer and the employees are subject to the rules governing those types of arrangements, including potentially § 409A. Under the economic benefit regime of the split-dollar life insurance arrangement rules set forth in § 1.61–22, the employee must include in income the full value of the economic benefits provided to the employee under the arrangement for the taxable year without a corresponding employer deduction.

If, based on the facts and circumstances, an arrangement described above is properly characterized as a welfare benefit fund for purposes of §§ 419 and 419A (rather than a dividend arrangement, a plan deferring the receipt of compensation, or a split-dollar life insurance arrangement), an employer is allowed a deduction for contributions to the trust or other welfare benefit fund only to the extent allowed under §§ 419 and 419A. Under §§ 419 and 419A, no deduction is allowed with respect to premiums paid for life insurance coverage provided to current employees if the welfare benefit fund or the employer is directly or indirectly a beneficiary under the life insurance policy within the meaning of § 264(a). In the promoted arrangements discussed above, the trust typically retains rights in the life insurance policies and is directly or indirectly a beneficiary under the policies, so that no deduction is allowed with respect to the life insurance premiums. *See* Situation 1 in Rev. Rul. 2007–65. Further, any deduction with respect to uninsured benefits (for example, uninsured medical, disability, or severance benefits) is not based on the premiums paid on the life insurance policies, but is generally limited to claims incurred and paid during the year.[1] *See* Situation 2 in Rev. Rul. 2007–65. Thus, contrary to the claims made by persons advocating the use of the arrangements discussed above, premiums on cash value life insurance policies paid through the trust are not a justification for claiming a deduction under §§ 419 and 419A.

Moreover, in appropriate cases, the IRS intends to challenge the value claimed by the taxpayer for property distributed from the trust, including cash value life insurance policies.

The above conclusions apply whether the trust used to provide the plan benefits is a taxable trust or a VEBA. While the trust may have received a determination letter stating the trust is exempt under § 501(c)(9), a letter of this type does not address the tax deductibility of contributions to the trust with respect to the employer nor the income inclusion with respect to the employees.

The IRS has previously identified certain other transactions that claim to be welfare benefit funds as listed transactions, concluding that the tax benefits claimed to be generated by these transactions are not allowable for federal income tax purposes. Notice 2003–24, 2003–1 C.B. 853, describes certain transactions purporting to meet the exception under § 419A(f)(5) for collectively bargained plans and identifies those and substantially similar transactions as listed transactions, and Notice 95–34, 1995–1 C.B. 309, describes transactions that purport to meet the 10-or-more employer plan exception under § 419A(f)(6). The transactions described in Notice 95–34 and substantially similar transactions have also been identified as listed transactions. See Notice 2004–67, 2004–2 C.B. 600.

LISTED TRANSACTIONS

1. Transactions Identified As Listed Transactions

Any transaction that has all of the following elements, and any transaction that is substantially similar to such a transaction, are identified as "listed transactions" for purposes of § 1.6011–4(b)(2) and §§ 6111 and 6112, effective October 17, 2007, the date this notice is released to the public.

(1) The transaction involves a trust or other fund described in § 419(e)(3) that is purportedly a welfare benefit fund.

(2) For determining the portion of its contributions to the trust or other fund that are currently deductible the employer does not rely on the exception in § 419A(f)(5)(A) (regarding collectively bargained plans).

(3) The trust or other fund pays premiums (or amounts that are purported to be premiums) on one or more life insurance policies and, with respect to at least one of the policies, value is accumulated either:

(a) within the policy (for example, a cash value life insurance policy); or

(b) outside the policy (for example, in a side fund or through an agreement outside the policy allowing the policy to be converted to or exchanged for a policy which will, at some point in time, have accumulated value based on the purported premiums paid on the original policy).

(4) The employer has taken a deduction for any taxable year for its contributions to the fund with respect to benefits provided under the plan (other than post-retirement medical benefits, post-retirement life insurance benefits, and child care facilities) that is greater than the sum of the following amounts:

(a) With respect to any uninsured benefits provided under the plan,

(i) an amount equal to claims that were both incurred and paid during the taxable year; plus

(ii) the limited reserves allowable under § 419A(c)(1) or (c)(3), as applicable; plus

(iii) amounts paid during the taxable year to satisfy claims incurred in a prior taxable year (but only to the extent that no deduction was taken for such amounts in a prior year); plus

[1] Limited deductions are allowable under §§ 419 and 419A for additions to certain reserves, including a reserve for claims incurred but unpaid as of the close of a taxable year.

(iv) amounts paid during the taxable year or a prior taxable year for administrative expenses with respect to uninsured benefits and that are properly allocable to the taxable year (but only to the extent that no deduction was taken for such amounts in a prior year).

(b) With respect to any insured benefits provided under the plan,

(i) insurance premiums paid during the taxable year that are properly allocable to the taxable year (other than premiums paid with respect to a policy described in (3)(a) or (b) above); plus

(ii) insurance premiums paid in prior taxable years that are properly allocable to the taxable year (other than premiums paid with respect to a policy described in (3)(a) or (b) above); plus

(iii) amounts paid during the taxable year or a prior taxable year for administrative expenses with respect to insured benefits and that are properly allocable to the taxable year (but only to the extent that no deduction was taken for such amounts in a prior year).

(c) For taxable years ending prior to November 5, 2007, with respect to life insurance benefits provided through policies described in (3)(a) and (b) above, the greater of the following amounts:[2]

(i) in the case of an employer with a taxable year that is the calendar year, the aggregate amounts reported by the employer as the cost of insurance with respect to such policies on the employees' Forms W–2 (or Forms 1099) for that year, plus an amount equal to the amounts that would have been reportable on the employees' Forms W–2 for that year, but for the exclusion under section 79 (relating to the cost of up to $50,000 of coverage); or, in the case of an employer with a taxable year other than the calendar year, the portions of the aggregate amounts reported by the employer on the Forms W–2 (or Forms 1099) as described in (i), above, (or that would have been reported absent the exclusion under § 79) that are properly allocable to the employer's taxable year; and

(ii) with respect to each employee insured under a cash value life insurance policy, the aggregate cost of insurance charged under the policy or policies with respect to the amount of current life insurance coverage provided to the employee under the plan (but limited to the product of the current life insurance coverage under the plan multiplied by the current year's mortality rate provided in the higher of the 1980 or 2001 CSO Table).

(d) The additional reserve, if any, under § 419A(c)(6) (relating to medical benefits provided through a plan maintained by a *bona fide* association), but only to the extent amounts are not already included above in this paragraph (4), and only to the extent that no deduction was taken for such amounts in a prior taxable year.

2. Participation in the Listed Transactions

Whether a taxpayer has participated in the listed transaction described in this notice will be determined under § 1.6011–4(c)(3)(i)(A). However, an individual who is not the employer will be treated as a participant for a taxable year if, and only if the individual owns, directly or indirectly, 20 percent or more of an entity, other than a C corporation, that is a participant in the listed transaction for the taxable year. For this purpose, indirect ownership is determined under rules similar to the rules of § 318 but without regard to the family attribution rules of § 318(a)(1).

3. Disclosure, List Maintenance, and Registration Requirements; Penalties; Other Considerations

In general, if a taxpayer has participated in a listed transaction, the rules of § 1.6011–4(e) determine when a disclosure statement must be filed by the taxpayer. However, if, under § 1.6011–4(e), a taxpayer is required to file a disclosure statement with respect to the listed transaction described in this notice after October 17, 2007, and prior to January 15, 2008, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure statement with the Office of Tax Shelter Analysis (OTSA) by January 15, 2008.

Some transactions described in Notice 95–34 and substantially similar transactions may be identified as a listed transaction in this notice also. It should be noted that, independent of their classification as "listed transactions" for purposes of § 1.6011–4(b)(2) and §§ 6111 and 6112, transactions that are the same as, or substantially similar to, the transaction identified in this notice may already be subject to the requirements of §§ 6011, 6111, 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011–4 and who fail to do so may be subject to the penalty under § 6707A.[3] Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who fail to do so (or who fail to provide such lists when requested by the IRS) may be subject to the penalty under § 6708(a).

In addition, the IRS may impose other penalties on persons involved in this transaction or substantially similar transactions (including the accuracy-related penalty under § 6662 or 6662A) and, as applicable, on persons who participate in the promotion or reporting of this transaction or substantially similar transactions (including the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701).

Further, under § 6501(c)(10), the period of limitations on assessment may be extended beyond the general three-year period of limitations for persons required to disclose transactions under § 1.6011–4 who fail to do so. See Rev. Proc. 2005–26, 2005–1 C.B. 965.

The IRS and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

The principal authors of this notice are Larry Isaacs of the Employee Plans, Tax Exempt and Government Entities Division and Betty Clary of the Office

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[2] For taxable years ending on or after November 5, 2007, the amount under this (4)(c) is zero.

[3] Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005–11, 2005–1 C.B. 493. The amount of the penalty under § 6707A with respect to a listed transaction is $100,000 in the case of a natural person and $200,000 in any other case.

of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Isaacs at *RetirementPlanQuestions@irs.gov* or Ms. Clary at (202) 622–6080 (not a toll-free call).

Trust Arrangements Purporting to Provide Nondiscriminatory Post-Retirement Medical and Life Insurance Benefits

Notice 2007–84

Sections 419 and 419A of the Internal Revenue Code set forth rules under which employers are permitted to make currently deductible contributions to welfare benefit funds in order to provide their retirees with medical and life insurance benefits. Businesses often maintain welfare benefit funds that comport with the intent of §§ 419 and 419A and do in fact provide meaningful medical and life insurance benefits to retirees on a nondiscriminatory basis, and make substantial contributions to those welfare benefit funds that are fully deductible. Such welfare benefit funds are outside the scope of this notice.

This notice addresses certain trust arrangements that are being promoted to and used by small businesses to avoid federal income and employment taxes. The arrangements described in this notice involve purported welfare benefit funds that, in form, provide post-retirement medical and life insurance benefits to employees on a nondiscriminatory basis, but that, in operation, will primarily benefit the owners or other key employees of the businesses. This notice alerts taxpayers and their representatives that the tax treatment of these arrangements may vary from the claimed tax treatment. The Internal Revenue Service (IRS) may issue further guidance to address these arrangements, and taxpayers should not assume that the guidance will be applied prospectively only.

Concurrently with this notice, the IRS is publishing Notice 2007–83, this Bulletin, which identifies as listed transactions certain transactions involving purported welfare benefit fund arrangements using cash value life insurance policies. The fact that an arrangement is described in this notice does not preclude it from also being a listed transaction under Notice 2007–83 where the arrangement provides benefits to active employees as well as to retired employees.

The IRS has previously identified certain other transactions that claim to be welfare benefit funds as listed transactions. Notice 2003–24, 2003–1 C.B. 853, describes certain transactions purporting to meet the exception under § 419A(f)(5) of the Internal Revenue Code for collectively bargained plans. Notice 95–34, 1995–1 C.B. 309, describes transactions that purport to meet the 10-or-more employer plan exception under § 419A(f)(6). Notice 2004–67, 2004–2 C.B. 600, includes transactions described in Notice 2003–24 and Notice 95–34, as well as substantially similar transactions, as listed transactions.

BACKGROUND

Promoted trust arrangements claiming to provide nondiscriminatory post-retirement medical benefits and post-retirement life insurance benefits have recently come to the attention of the IRS. These arrangements, among others, may be referred to by persons advocating the use of the plans as "single employer plans" or "419(e) plans." These purported welfare benefit arrangements are usually sold to small businesses and other closely held businesses as a way to provide post-retirement medical benefits, post-retirement life insurance, and cash and other property to the owners or other key employees of the business on a tax-favored basis through the use of a trust. Those advocating the use of these plans usually assert that the contributions are tax-deductible, but with no corresponding inclusion by the owner or other key employee. Some of these arrangements involve plans that previously had claimed to be 10-or-more employer plans under § 419A(f)(6); some others were established to receive policies transferred from terminating plans that claimed to be 10-or-more employer plans.

A promoted arrangement may involve either a taxable trust or a tax-exempt trust, *i.e.*, a voluntary employees' beneficiary association (VEBA) that has received a determination letter from the IRS that it is described in § 501(c)(9). The trust frequently uses the employer's contributions to purchase cash value life insurance policies on the lives of employees who are owners of the business and, sometimes, on the lives of other key employees.

The amount of the employer's deduction for contributions to one of these plans is often based on a calculation of a reserve associated with each of the plan participants. However, the calculation may be based on an unreasonable assumption that all of the covered employees will eventually receive post-retirement benefits under the plan, or may be based on other actuarial assumptions that either are not reasonable or are not permitted to be reflected in the reserve calculations for purposes of §§ 419 and 419A.

Under some arrangements, the plan documents may indicate that post-retirement benefits will be provided on a nondiscriminatory basis when, in fact, only a few employees (primarily the employees who are also owners of the business) will ever receive those benefits. To the extent a trust holds excess assets not needed to pay the original benefits, the owner will also receive a substantial portion of those assets. Under some arrangements, this will be accomplished through the use of "loans" to the owners. For some arrangements, the plan will be amended to provide benefits other than the plan's original post-retirement medical or life insurance benefits. For others, the plan will be terminated prior to the payment of the post-retirement benefits and the timing of the termination and the methods used to allocate the remaining assets are structured so that the owners and other key employees will receive, directly or indirectly, all or a substantial portion of the assets held by the trust.

Persons advocating the use of these plans claim that the employer's contributions for the post-retirement medical and life benefits are deductible under §§ 419 and 419A as additions to a qualified asset account. They may also claim that owners or other key employees receive the economic benefits from the contributions with little or no income inclusion.

LAW

Sections 419 and 419A prescribe limits on the amount of deductions for contributions paid or accrued by an employer

to a welfare benefit fund. A welfare benefit fund generally consists of a taxable or exempt trust, corporation, or other organization that is part of a plan of an employer through which the employer provides welfare benefits to employees or their beneficiaries. Under § 419, the employer's contributions to a welfare benefit fund are deductible only if they would otherwise be deductible under Chapter 1 of the Code, and the amount of the deduction is limited to the welfare benefit fund's qualified cost for the taxable year.

One component of qualified cost is a fund's qualified direct cost for the year, which is the amount (including administrative expenses) that would have been allowable as a deduction to the employer with respect to the benefits provided during the year if those benefits had been provided directly by the employer, and the employer had used the cash receipts and disbursements method of accounting. A second component of qualified cost is any addition to a qualified asset account for the taxable year, but only to the extent the addition does not exceed specified limits. Further, the qualified cost for the taxable year is reduced by the fund's after-tax income for the year.

Under § 419A(a), the term "qualified asset account" means any account consisting of assets set aside to provide for the payment of disability benefits, medical benefits, supplemental unemployment benefits or severance pay benefits, or life insurance benefits. Sections 419A(b) and 419A(c)(1) generally limit the additions to a qualified asset account to an amount that is reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for the benefits referred to above, plus administrative costs with respect to those claims.

Section 419A(c)(2) allows additional limited reserves for post-retirement medical and post-retirement life insurance benefits. The reserves must be funded over the working lives of the covered employees and must be actuarially determined on a level basis using assumptions that are reasonable in the aggregate as necessary for the post-retirement benefits to be provided to the covered employees. For purposes of § 419A(c)(2), contributions to a reserve are deductible under § 419A only if the contributions are intended to actually accumulate for the purpose of funding the post-retirement benefits. *General Signal Corporation v. Commissioner*, 142 F.2d 546 (2d Cir. 1998).

Under § 419A(c)(2)(A), the reserve for post-retirement medical benefits is further limited by the requirement that it be determined on the basis of current medical costs. In addition, for post-retirement life insurance the maximum insurance coverage that can be taken into account with respect to any covered employee is $50,000 of coverage. Moreover, in the case of post-retirement benefits for or on behalf of a key employee (as defined in § 416(i)(1)), § 419A(d) requires that a separate account be established for any medical or life insurance benefits provided with respect to the key employee, and any medical or life insurance benefits provided with respect to the key employee after retirement may only be paid from the separate account. Under § 419A(e)(1), in order for reserves for post-retirement medical and life insurance benefits to be taken into account the plan must meet the nondiscrimination requirements of § 505(b) with respect to those benefits (even if those requirements do not otherwise apply to the plan).

A plan meets the nondiscrimination requirements of § 505(b) only if (i) each class of benefits under the plan is provided under a classification of employees which is set forth in the plan and which is found by the Secretary not to be discriminatory in favor of employees who are highly compensated individuals, and (ii) in the case of each class of benefits, such benefits do not discriminate in favor of employees who are highly compensated individuals. Under § 505(b)(3), in the case of any benefit for which another section of the Code provides nondiscrimination rules (*e.g.*, § 105(h) in the case of a self-insured medical reimbursement plan), those rules apply instead with respect to the benefit. Under §§ 105(h)(8) and 414(t), all employees who are treated as employed by a single employer under the rules of § 414(b), (c), or (m) are treated as employed by a single employer for purposes of §§ 105(h), 79, and 505.

Sections 104(a)(3) and 105(b), (c), and (d) exclude from gross income certain amounts received by an employee through accident and health insurance. Section 105(e) provides that for purposes of §§ 104 and 105, amounts received through an "accident and health plan for employees" are treated as amounts received through accident or health insurance. Thus, the plan must exist primarily for the benefit of employees, as opposed to shareholders. See, *e.g.*, *Larkin v. Commissioner*, 48 T.C. 629 (1967), *aff'd*, 394 F.2d 494 (1st Cir. 1968) (holding that the plan was merely a device to use corporate earnings to meet the anticipated medical needs of the shareholders).

Section 4976(a) imposes on an employer an excise tax in the amount of 100 percent of the amount of any disqualified benefit provided with respect to a welfare benefit fund maintained by the employer. Under § 4976(b)(1), a "disqualified benefit" means (i) any post-retirement medical benefit or life insurance benefit provided with respect to a key employee if a separate account is required to be established for the key employee under § 419A(d) and the payment is not from that employee's account; (ii) any post-retirement medical benefit or life insurance benefit provided with respect to an individual in whose favor discrimination is prohibited unless the plan meets the requirements of § 505(b) with respect to the benefit (whether or not the § 505(b) requirements apply to the plan); and (iii) any portion of a welfare benefit fund reverting to the benefit of the employer.

INTENT TO CHALLENGE ARRANGEMENTS

The IRS may challenge the claimed tax benefits for the above-described arrangements for various reasons. Depending on the facts and circumstances of a particular arrangement, contributions to a purported welfare benefit arrangement on behalf of an employee who is an owner may properly be characterized as dividends or as non-qualified deferred compensation subject to § 404(a)(5) or 409A (or both), or the arrangement may be subject to the rules for split-dollar life insurance arrangements. See Notice 2007–83.

If, based on the facts and circumstances, an arrangement described above is properly characterized as a welfare benefit fund, an employer's deductions for contributions to the welfare benefit trust or other fund are subject to the rules of §§ 419 and 419A. Under those rules, deductions for post-retirement medical and life benefits are subject to a number of limitations and requirements, including

the use of reasonable actuarial assumptions, the requirement that the plan meet the nondiscrimination requirements of § 505(b) (determined after application of the rules of § 414(b), (c), and (m)), a prohibition against considering future increases in medical costs, and a limit on the reserves for post-retirement life insurance benefits to the reserves that would apply with respect to $50,000 of coverage. Moreover, in order to obtain a deduction for reserves for post-retirement medical or life benefits, the taxpayer cannot get a deduction unless the employer actually intends to use the contributions for that purpose.

The tax benefit rule may require that some or all of the deductions taken by the employer in earlier years be included in its income in a later year in which an event occurs that is fundamentally inconsistent with the premise on which the deductions were initially based. (For a further discussion of the tax benefit rule, see *Hillsboro National Bank v. Commissioner*, 460 U.S. 370 (1983)).

Further, the IRS intends to challenge the claimed value of property distributed from a trust, including life insurance policies, whenever the property has not been properly valued by the taxpayer.

Finally, based on the facts and circumstances of a particular arrangement, some or all of the benefits or distributions provided to or for the benefit of employees who are also owners or other key employees may be disqualified benefits for purposes of § 4976 subjecting the employer to a 100% excise tax.

Taxpayers should be aware that the IRS may impose penalties on persons involved in these arrangements or similar arrangements (including the accuracy-related penalty under § 6662) and, as applicable, on persons who participate in the promotion or reporting of these arrangements or similar arrangements (including the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701).

The above rules apply whether the trust used to provide benefits under the arrangement is a taxable trust or a VEBA. While the trust may have received a determination letter stating the trust is exempt under § 501(c)(9), a letter of this type does not address the tax deductibility of contributions to the trust with respect to the employer, nor the income inclusion with respect to the employees.

DRAFTING INFORMATION

The principal authors of this notice are Larry Isaacs of the Employee Plans, Tax Exempt and Government Entities Division and Betty Clary of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Mr. Isaacs at *RetirementPlanQuestions@irs.gov* or Ms. Clary at (202) 622–6080 (not a toll-free call).

Form 8918 — Section 6111 Disclosures

Notice 2007–85

This notice provides guidance to material advisors required to file a disclosure statement by October 31, 2007, under § 301.6111–3 of the Procedure and Administration Regulations.

BACKGROUND

On August 3, 2007, the Internal Revenue Service and Treasury Department published final regulations under § 301.6111–3 in the Federal Register (72 FR 43157) providing the rules relating to the disclosure of reportable transactions by material advisors under section 6111 of the Internal Revenue Code. See T.D. 9351, 2007–38 I.R.B. 616. In general, these regulations apply to transactions with respect to which a material advisor makes a tax statement on or after August 3, 2007. However, these regulations apply to transactions of interest entered into on or after November 2, 2006, with respect to which a material advisor makes a tax statement on or after November 2, 2006.

The regulations provide that each material advisor, with respect to any reportable transaction, must file a return as described in § 301.6111–3(d). Section 301.6111–3(d) provides that each material advisor required to file a disclosure statement under § 301.6111–3 must file a completed Form 8918, "*Material Advisor Disclosure Statement*" (or successor form). The Form 8918 must be filed with the Office of Tax Shelter Analysis (OTSA) by the last day of the calendar month that follows the end of the calendar quarter in which the advisor became a material advisor with respect to the reportable transaction or in which the circumstances necessitating an amended disclosure occur.

Prior to the publication of the final regulations, material advisors were required to disclose reportable transactions on Form 8264, "*Application for Registration of a Tax Shelter*." Notice 2004–80, 2004–2 C.B. 963, and Notice 2005–22, 2005–1 C.B. 756, described the manner in which the Form 8264 was to be completed.

INTERIM PROVISION

The next due date for disclosures by material advisors is October 31, 2007. As of the date of release of this notice, Form 8918 has not yet been published. The IRS anticipates that the Form 8918 will be published soon.

Due to the unavailability of Form 8918, a material advisor required to file a completed Form 8918 by October 31, 2007, will be treated as satisfying the disclosure requirement of § 301.6111–3(d) if the material advisor files Form 8264 instead. If Form 8918 is published on or before October 31, 2007, material advisors may choose to use either Form 8918 or Form 8264 for disclosures required to be filed by October 31, 2007. For disclosures required to be filed after October 31, 2007, material advisors must use Form 8918 (or successor form) unless instructed otherwise by the IRS. Reportable transactions disclosed on the Form 8264 should be disclosed in the manner described in Notice 2004–80 and Notice 2005–22.

EFFECTIVE DATE

This notice is effective October 16, 2007, the date this notice was released to the public.

DRAFTING INFORMATION

The principal author of this notice is Charles D. Wien of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Charles D. Wien at 202–622–3070 (not a toll-free call).

2008 Limitations Adjusted As Provided in Section 415(d), etc.[1]

Notice 2007–87

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415 also requires that the Commissioner annually adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments. Many of the limitations will change for 2008 because the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment. However, for others, the limitation will remain unchanged. For example, the limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) remains unchanged at $15,500. This limitation affects elective deferrals to section 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

Cost-of-Living limits for 2008

Effective January 1, 2008, the limitation on the annual benefit under a defined benefit plan under § 415(b)(1)(A) is increased from $180,000 to $185,000. For participants who separated from service before January 1, 2008, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2007, by 1.0236.

The limitation for defined contribution plans under § 415(c)(1)(A) is increased from $45,000 to $46,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of § 415(b)(1)(A). These dollar amounts and the adjusted amounts are as follows:

> The limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) remains unchanged at $15,500.
>
> The annual compensation limit under §§ 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) is increased from $225,000 to $230,000.
>
> The dollar limitation under § 416(i)(1)(A)(i) concerning the definition of key employee in a top-heavy plan is increased from $145,000 to $150,000.
>
> The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $915,000 to $935,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $180,000 to $185,000.
>
> The limitation used in the definition of highly compensated employee under § 414(q)(1)(B) is increased from $100,000 to $105,000.
>
> The dollar limitation under § 414(v)(2)(B)(i) for catch-up contributions to an applicable employer plan other than a plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over remains unchanged at $5,000. The dollar limitation under § 414(v)(2)(B)(ii) for catch-up contributions to an applicable employer plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over remains unchanged at $2,500.
>
> The annual compensation limitation under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $335,000 to $345,000.
>
> The compensation amount under § 408(k)(2)(C) regarding simplified employee pensions (SEPs) remains unchanged at $500.
>
> The limitation under § 408(p)(2)(E) regarding SIMPLE retirement accounts remains unchanged at $10,500.
>
> The limitation on deferrals under § 457(e)(15) concerning deferred compensation plans of state and local governments and tax-exempt organizations remains unchanged at $15,500.
>
> The compensation amounts under § 1.61–21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes remains unchanged at $90,000. The compensation amount under § 1.61–21(f)(5)(iii) is increased from $180,000 to $185,000.

The Code also provides that several pension-related amounts are to be adjusted using the cost-of-living adjustment under § 1(f)(3). These dollar amounts and the adjustments are as follows:

> The adjusted gross income limitation under § 25B(b)(1)(A) for determining the retirement savings contribution credit for taxpayers filing a joint return is increased from $31,000 to $32,000; the limitation under § 25B(b)(1)(B) is increased from $34,000 to $34,500; and the limitation under § 25B(b)(1)(C) and (D) is increased from $52,000 to $53,000.
>
> The adjusted gross income limitation under § 25B(b)(1)(A) for determining the retirement savings contribution credit for taxpayers filing as head of household is increased from $23,250 to $24,000; the limitation under § 25B(b)(1)(B) is increased from $25,500 to $25,875; and the limitation under § 25B(b)(1)(C) and (D) is increased from $39,000 to $39,750.
>
> The adjusted gross income limitation under § 25B(b)(1)(A) for determining the retirement savings contribution credit for all other taxpayers is increased from $15,500 to $16,000; the limitation under § 25B(b)(1)(B) is increased from $17,000 to $17,250; and the limitation under § 25B(b)(1)(C) and (D) is increased from $26,000 to $26,500.
>
> The applicable dollar amount under § 219(g)(3)(B)(i) for determining the deductible amount of an IRA contribution for taxpayers who are active participants filing a joint return or as a qualifying widow(er) is increased from $83,000 to $85,000. The applicable dollar amount under § 219(g)(3)(B)(ii) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $52,000 to $53,000. The applicable dollar amount under § 219(g)(7)(A) for a taxpayer who is not an active participant but whose

[1] Based on News Release IR–2007–171 dated October 18, 2007.

spouse is an active participant is increased from $156,000 to $159,000.

The adjusted gross income limitation under § 408A(c)(3)(C)(ii)(I) for determining the maximum Roth IRA contribution for taxpayers filing a joint return or as a qualifying widow(er) is increased from $156,000 to $159,000.

The adjusted gross income limitation under § 408A(c)(3)(C)(ii)(II) for all other taxpayers (other than married taxpayers filing separate returns) is increased from $99,000 to $101,000.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

Drafting Information

The principal author of this notice is John Heil of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding the data in this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free call) between the hours of 8:30 a.m. and 4:30 p.m. Eastern time Monday through Friday. For information regarding the methodology used in arriving at the data in this notice, please e-mail Mr. Heil at *RetirementPlanQuestions@irs.gov*.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also: §§ 45, 704, 1.704–1.)

Rev. Proc. 2007–65

SECTION 1. PURPOSE

Notice 2006–88, 2006–42 I.R.B. 686, regarding Electricity Produced from Open-Loop Biomass, announced that the Internal Revenue Service (the "Service") would not rule on any issues under Subchapter K for partnerships claiming the credit under § 45 of the Internal Revenue Code. This revenue procedure establishes the requirements (the Safe Harbor) under which the Service will respect the allocation of § 45 wind energy production tax credits by partnerships in accordance with § 704(b). The Treasury Department and the Service intend for the Safe Harbor to simplify the application of § 45 to partners and partnerships that own and produce electricity from qualified wind energy facilities.

SECTION 2. BACKGROUND

Section 45 provides for a renewable electricity production credit in an amount equal to the product of 1.5 cents, multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service, and sold by the taxpayer to an unrelated person during the taxable year.

Section 45(c)(1) defines "qualified energy resources" to include wind. Section 45(d)(1) defines a "qualified facility" in the case of a facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and before January 1, 2009.

Under Rev. Rul. 94–31, 1994–1 C.B. 16, with respect to electricity produced from wind energy, the term "facility" under § 45(d)(1) means each separate wind turbine, together with the tower on which the turbine is mounted and the supporting pad on which the tower is situated. Although § 45 does not define "placed in service," the term has been defined for purposes of the deduction for depreciation and the investment tax credit. For these purposes, property is considered to be placed in service in the taxable year that the property is placed in a condition or state of readiness and available for a specifically assigned function. See §§ 1.46–3(d)(1)(ii) and 1.167(a)–11(e)(1)(i) of the Income Tax Regulations.

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit is, except as otherwise provided in chapter 1 of subtitle A of Title 26, determined by the partnership agreement. Under § 704(b), a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if (i) the partnership agreement does not provide for the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (ii) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) lacks substantial economic effect.

Section 1.704–1(b)(4)(ii) provides that allocations of tax credits and tax credit recapture (except for § 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under § 1.704–1(b)(2)(ii)(*b*)(*1*), and the tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit or credit recapture arises. If a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustments) for the year, then the partners' interests in the partnership with respect to the credit (or the cost giving rise to it) are in the same proportion as the partners' respective distributive shares of the loss or deduction (and adjustments). See § 1.704–1(b)(5), Example 11. Section 1.704–1(b)(4)(ii) further provides that identical principles apply in determining the partners' interests in the partnership regarding tax credits, such as the credit under § 45, that arise from receipts of the partnership (whether or not taxable).

SECTION 3. SCOPE

The Safe Harbor in section 4 of this revenue procedure applies to any partnership (the "Project Company") between a project developer (the "Developer") and one or more investors, as defined in section 4.01 (the "Investors"), with the Project Company owning and operating the project containing the qualified energy facilities ("Wind Farm" and for purposes of this definition the term does not include energy produced from such Wind Farm). In addition to the Project Company, the Developer, and the Investors, wind energy transactions typically involve lenders, land owners, a turbine supplier, a construction contractor, power purchasers, and a project operator. In order to qualify for the Safe Harbor, all of the requirements set forth in section 4 of this revenue procedure must be met. This Safe Harbor will apply only if the Developer, Investors and Project Company satisfy

each and every requirement in section 4 of this revenue procedure. Furthermore, this revenue procedure applies only to partners or partnerships with § 45 production tax credits from renewable resources from wind. Thus, this revenue procedure does not apply to any other tax credits.

The Service generally will closely scrutinize a Project Company as a partnership or Investors as partners if a Project Company's partnership agreement does not satisfy each requirement of this revenue procedure. The Safe Harbor in this revenue procedure is to provide guidance to taxpayers establishing or participating in wind energy partnerships in lieu of taxpayers requesting a letter ruling. Therefore, the Service will not rule on any issues under Subchapter K for partnerships claiming the credit under § 45.

SECTION 4. SAFE HARBOR

.01 *Investors Defined.* Investors are partners in the Project Company whose investment return is reasonably anticipated to be derived from both § 45 credits and participation in operating cash flow.

.02 *Partners' Minimum Partnership Interest.* The Developer must have a minimum one percent interest in each material item of partnership income, gain, loss, deduction and credit at all times during the existence of the Project Company. Each Investor must have, at all times during the period it owns a partnership interest in the Project Company, a minimum interest in each material item of partnership income and gain equal to 5 percent of the Investor's percentage interest in partnership income and gain for the taxable year for which the Investor's percentage share of income and gain will be the largest, as adjusted for sales, redemptions or dilution of its interest.

.03 *Investor's Minimum Unconditional Investment.* On or before the later of the date the Wind Farm is placed in service or the date the Investor acquires its interest in the Project Company, the Investor must make a minimum unconditional investment in the Project Company (the "Investor Minimum Investment"). The Investor must maintain the Investor Minimum Investment throughout the duration of its ownership of its partnership interest in the Project Company, except that the Investor Minimum Investment can be reduced as a result of distributions of cash flow from the Project Company's operation of the Wind Farm or in connection with section 4.05. Contributions required to be made in the future will not be included in the Investor Minimum Investment until the contributions are actually made to the partnership. The Investor Minimum Investment must be equal to at least 20 percent of the sum of the fixed capital contributions plus reasonably anticipated contingent capital contributions required to be made by the Investor under the partnership agreement. The Investor must not be protected against loss of any portion of the Investor Minimum Investment through any arrangement, directly or indirectly, with the Developer, any other Investor, the turbine supplier or the power purchaser or any party related to the Developer, other Investors, turbine supplier or the power purchaser.

.04 *Contingent Consideration.* At least 75 percent of the sum of the fixed capital contributions plus reasonably anticipated contingent capital contributions to be contributed by an Investor with respect to an interest in the Project Company must be fixed and determinable obligations that are not contingent in amount or certainty of payment.

.05 *Purchase Rights.* Neither the Developer, the Investors nor any related parties may have a contractual right to purchase, at any time, the Wind Farm, any property included in the Wind Farm or an interest in the Project Company at a price less than its fair market value determined at the time of exercise of the contractual right to purchase, and provided further that the Developer (or any party related to the Developer) may not have a contractual right to purchase the Wind Farm or an interest in the Project Company earlier than 5 years after the qualified facility is first placed into service.

Any determination of the fair market value of the Wind Farm or an interest in the Project Company may take into account: (i) contracts or other arrangements creating rights or obligations (excluding power purchase agreements) only if such contracts or other arrangements creating rights or obligations are entered into in the ordinary course of the Wind Farm's business and are negotiated at arm's length with parties not related to the Project Company or Investors; and (ii) any power purchase contract only if such contract is entered into with parties not related to (within the meaning of § 45(e)(4)) to the Project Company.

.06 *Sale Rights.* The Project Company may not have a contractual right to cause any party to purchase the Wind Farm or any property included in the Wind Farm, excluding electricity, from the Project Company. An Investor may not have a contractual right to cause any party to purchase its partnership interest in the Project Company.

.07 *Guarantees and Loans.* No person may guarantee or otherwise insure the Investor the right to any allocation of the credit under § 45.

The Project Company must bear the risk that the available wind resource is not as great as anticipated or projected. The Developer, the turbine supplier, or any power purchaser may not provide a guarantee that the wind resource will be available at a certain level. A guarantee regarding wind resource availability may be provided by a third party not related to the Developer, the turbine supplier, any power purchaser, or any other project participant if the Project Company or an Investor directly pays the cost of or premium for such guarantee. For example, a weather derivative contract between the Project Company and an unrelated third party (such as an insurance company) is an acceptable guarantee.

A long-term power purchase agreement entered into between the Project Company and a party not related to the Project Company under § 45(e)(4) does not constitute a guarantee. However, a Take or Pay contract between related parties would constitute a guarantee and is not permissible. Any sale of electricity between related persons as defined in § 45(e)(4) will not qualify for the credit under § 45.

The Developer (or a party related to the Developer) may not lend any Investor the funds to acquire any part of the Investor's interest in the Project Company or guarantee any indebtedness incurred or created in connection with the acquisition of such Investor's interest in the Project Company.

.08 *Allocation of § 45 Production Tax Credits.* The § 45 credit must be allocated in accordance with § 1.704–1(b)(4)(ii).

.09 *Separate Activity for Purposes of § 469.* For purposes of the passive activity loss rules, under § 1.469–4(d)(4) each qualified facility will be treated as a sep-

arate activity for purposes of § 469 and that activity may not be grouped with any other activity, except other qualified wind facilities. Thus, generally, only entities not subject to § 469, and not individuals, will be able to offset non-project income with credits received as a passive investor in a partnership.

.10 *Definition of Related Party.* Except as otherwise provided, for purposes of this revenue procedure parties are related if they bear a relationship to each other that is specified in § 267(b) or 707(b)(1).

SECTION 5. EXAMPLES

.01 *Example 1.* The following is an example of a valid wind energy limited liability company that is classified as a partnership for federal tax purposes. Developer is a C corporation that owns and manages wind-based generation projects. Project Company is a limited liability company (LLC) that has been formed by Developer to develop, own and manage a renewable energy project that utilizes wind turbines to produce electricity from wind (the Project). Investor is a C corporation that invests in renewable energy projects primarily to benefit from § 45 credits. Developer has caused LLC to enter into, or has assigned to LLC, a number a contracts or agreements relating to the development of the Project.

Developer will own all of LLC during construction of the Project. Construction of the Project will be financed with $100x of construction financing. When construction of the Project is substantially complete, pursuant to a Membership Interest Purchase and Equity Capital Contribution Agreement, (1) Developer will contribute $15x to LLC, and (2) Investor will acquire newly issued membership interests from LLC in exchange for an upfront cash capital contribution in the amount of $10x which is 20% of Investor's total agreed capital contributions to LLC of $50x. Developer, as the developer of the Project, has not provided a guarantee to LLC or Investor regarding the level of the available wind resource at the Project or the amount of § 45 credits.

Pursuant to the limited liability company operating agreement (the "Operating Agreement"), Developer will have the right to manage LLC, subject to the right of Investor to consent to certain activities. Below is a chart and explanation that generally describes the distribution and allocation provisions applicable to Developer and Investor over various time periods.

	Developer		Investor	
	Cash	Gross Income/Loss and Section 45 Credits	Cash	Gross Income/Loss and Section 45 Credits
Period 1	100%	1%	0%	99%
Period 2	0%	1%	100%	99%
Period 3	95%	95%	5%	5%

During Period 1, 99% of LLC's gross income or loss and the § 45 credits will be allocated to Investor, and 100% of LLC's cash flows will be distributed to Developer. Period 1 will continue until the earlier of (i) such time that Developer has received aggregate cash distributions in an amount equal to the aggregate contributions made by Developer (*i.e.*, $15x) and (ii) a fixed outside date. Period 1 is expected to last four to six years. When Period 1 ends, Period 2 will begin.

During Period 2, 99% of LLC's gross income or loss and the § 45 credits will be allocated to, and 100% of LLC's cash flows will be distributed to Investor. Period 2 will continue until Investor has achieved an agreed after-tax internal rate of return (the "Flip Point"). Although the Flip Point might occur sooner, it is expected that the Flip Point will not occur until after the end of year 10 of the Project, at which time § 45 credits will no longer be available for the production and sale of electricity from the Project. Period 2 is expected to last four to six years. When Period 2 ends, Period 3 will begin. Moreover, upon the tenth anniversary of Investor's investment, Developer will have the option to purchase Investor's interest for its then-appraised fair market value. Assuming that option is not exercised, during Period 3, 5% of LLC's gross income or loss and § 45 credits will be allocated to, and 5% of LLC's cash flows will be distributed to, Investor; and 95% of LLC's gross income or loss and § 45 credits will be allocated to, and 95% of LLC's cash flows will be distributed to, Developer. Period 3 will continue for the remaining life of the Project.

.02 *Example 2.* The facts are the same as in *Example 1*, except Investor is initially allocated 99.5% of LLC's gross income or loss and § 45 credits. Under these facts, the wind energy limited liability company's classification as a valid partnership would be closely scrutinized by the Service. Likewise, if any other provision of this safe harbor is not followed for any wind energy partnerships, the Service will closely scrutinize the validity of such purported partnerships.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for transactions entered into on or after the date of publication in the Internal Revenue Bulletin. If a Project Company, Developer and Investor satisfied all the requirements of the Safe Harbor provided in section 4 of this revenue procedure for transactions entered into before the date of publication of this revenue procedure in the Internal Revenue Bulletin, the Service will not challenge the allocation of § 45 wind energy production tax credits by the partnership that are in accordance with § 704(b) for such taxable year(s).

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Vishal R. Amin and Richard T. Probst of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Vishal R. Amin or Richard T. Probst at (202) 622–3060 (not a toll-free call).

26 CFR 601.602: Tax forms and instructions.
(Also Part I, §§ 1, 23, 24, 25A, 25B, 32, 42, 59, 62, 63, 68, 132, 135, 137, 146, 148, 151, 170, 179, 213, 219, 220, 221, 408A, 512, 513, 685, 877, 911, 2032A, 2503, 2523, 4161, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B; 1.148–3, 1.148–5.)

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SECTION 4. EFFECTIVE DATE

SECTION 5. DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 2008.

SECTION 2. CHANGES

.01 The excise taxes imposed under § 4261(b) and (c), as enacted by the Airport and Airway Trust Fund Tax Reinstatement Act of 1997 and extended by § 149(a) of Pub. L. No. 110–92, 121 Stat. 989 (2007), apply to transportation taken through November 16, 2007, and to amounts paid on or before November 16, 2007, for transportation beginning after that date. Accordingly, the amounts in § 4261(b) and (c) are not included in this revenue procedure.

.02 For 2008, the inflation adjusted items in §§ 25B, 219, and 408A also will be included in a separate news release and related notice with other inflation adjusted amounts relating to pension and retirement accounts. For future years, these amounts will not be included in this revenue procedure but will appear only in the separate news release and related notice.

.03 For taxable years beginning after 2007, the inflation adjusted items for health savings accounts under § 223 are published no later than June 1 of the preceding calendar year. See § 223(g) and Rev. Proc. 2007–36, 2007–22 I.R.B. 1335. Accordingly, these items are not included in this revenue procedure.

.04 Section 1.148–3(d)(1)(iv) of the proposed Income Tax Regulations provides that on the last day of each bond year during which there are amounts allocated to gross proceeds of an issue that are subject to the rebate requirement, and on the final maturity date, there can be included as a payment a computation credit of $1,400 for any bond year ending in 2007. For bond years ending after 2007, the $1,400 computation credit will be adjusted for inflation pursuant to proposed § 1.148–3(d)(4). See section 3.17 of this revenue procedure.

SECTION 3. 2008 ADJUSTED ITEMS

.01 *Tax Rate Tables.* For taxable years beginning in 2008, the tax rate tables under § 1 are as follows:

TABLE 1 — Section 1(a). — Married Individuals Filing Joint Returns and Surviving Spouses.

If Taxable Income Is:	*The Tax Is*:
Not over $16,050	10% of the taxable income
Over $16,050 but not over $65,100	$1,605 plus 15% of the excess over $16,050
Over $65,100 but not over $131,450	$8,962.50 plus 25% of the excess over $65,100
Over $131,450 but not over $200,300	$25,550 plus 28% of the excess over $131,450
Over $200,300 but not over $357,700	$44,828 plus 33% of the excess over $200,300
Over $357,700	$96,770 plus 35% of the excess over $357,700

TABLE 2 — Section 1(b). — Heads of Households.

If Taxable Income Is:	*The Tax Is*:
Not over $11,450	10% of the taxable income
Over $11,450 but not over $43,650	$1,145 plus 15% of the excess over $11,450
Over $43,650 but not over $112,650	$5,975 plus 25% of the excess over $43,650
Over $112,650 but not over $182,400	$23,225 plus 28% of the excess over $112,650
Over $182,400 but not over $357,700	$42,755 plus 33% of the excess over $182,400
Over $357,700	$100,604 plus 35% of the excess over $357,700

TABLE 3 — Section 1(c). — Unmarried Individuals (other than Surviving Spouses and Heads of Households).

If Taxable Income Is:	*The Tax Is*:
Not over $8,025	10% of the taxable income
Over $8,025 but not over $32,550	$802.50 plus 15% of the excess over $8,025
Over $32,550 but not over $78,850	$4,481.25 plus 25% of the excess over $32,550
Over $78,850 but not over $164,550	$16,056.25 plus 28% of the excess over $78,850
Over $164,550 but not over $357,700	$40,052.25 plus 33% of the excess over $164,550
Over $357,700	$103,791.75 plus 35% of the excess over $357,700

TABLE 4 — Section 1(d). — Married Individuals Filing Separate Returns.

If Taxable Income Is:	*The Tax Is*:
Not over $8,025	10% of the taxable income
Over $8,025 but not over $32,550	$802.50 plus 15% of the excess over $8,025
Over $32,550 but not over $65,725	$4,481.25 plus 25% of the excess over $32,550
Over $65,725 but not over $100,150	$12,775 plus 28% of the excess over $65,725
Over $100,150 but not over $178,850	$22,414 plus 33% of the excess over $100,150
Over $178,850	$48,385 plus 35% of the excess over $178,850

TABLE 5 — Section 1(e). — Estates and Trusts.

If Taxable Income Is:	*The Tax Is*:
Not over $2,200	15% of the taxable income
Over $2,200 but not over $5,150	$330 plus 25% of the excess over $2,200
Over $5,150 but not over $7,850	$1,067.50 plus 28% of the excess over $5,150
Over $7,850 but not over $10,700	$1,823.50 plus 33% of the excess over $7,850
Over $10,700	$2,764 plus 35% of the excess over $10,700

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For taxable years beginning in 2008, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $900. This amount is the same as the $900 standard deduction amount provided in section 3.11(2) of this revenue procedure. The same $900 amount is used for purposes of § 1(g)(7) (that is, to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the "kiddie tax"). For example, one of the requirements for the parental election is that a child's gross income is more than the

amount referenced in § 1(g)(4)(A)(ii)(I) but less than 10 times that amount; thus, a child's gross income for 2008 must be more than $900 but less than $9,000.

.03 *Adoption Credit.* For taxable years beginning in 2008, under § 23(a)(3) the credit allowed for an adoption of a child with special needs is $11,650. For taxable years beginning in 2008, under § 23(b)(1) the maximum credit allowed for other adoptions is the amount of qualified adoption expenses up to $11,650. The available adoption credit begins to phase out under § 23(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $174,730 and is completely phased out for taxpayers with modified adjusted gross income of $214,730 or more. (See section 3.15 of this revenue procedure for the adjusted items relating to adoption assistance programs.)

.04 *Child Tax Credit.* For taxable years beginning in 2008, the value used in § 24(d)(1)(B)(i) to determine the amount of credit under § 24 that may be refundable is $12,050.

.05 *Hope and Lifetime Learning Credits.*

(1) For taxable years beginning in 2008, the Hope Scholarship Credit under § 25A(b)(1) is an amount equal to 100 percent of qualified tuition and related expenses not in excess of $1,200 plus 50 percent of those expenses in excess of $1,200, but not in excess of $2,400. Accordingly, the maximum Hope Scholarship Credit allowable under § 25A(b)(1) for taxable years beginning in 2008 is $1,800.

(2) For taxable years beginning in 2008, a taxpayer's modified adjusted gross income in excess of $48,000 ($96,000 for a joint return) is used to determine the reduction under § 25A(d)(2)(A)(ii) in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise allowable under § 25A(a).

.06 *Elective Deferrals and IRA Contributions by Certain Individuals.* For taxable years beginning in 2008, the applicable percentage under § 25B(b) is determined based on the following amounts:

Modified Adjusted Gross Income						
Joint Return		*Head of Household*		*All Other Cases*		
Over	*Not Over*	*Over*	*Not Over*	*Over*	*Not Over*	*Applicable Percentage*
$ 0	$32,000	$ 0	$24,000	$ 0	$16,000	50%
$32,000	$34,500	$24,000	$25,875	$16,000	$17,250	20%
$34,500	$53,000	$25,875	$39,750	$17,250	$26,500	10%
$53,000		$39,750		$26,500		0%

.07 *Earned Income Credit.*

(1) *In general.* For taxable years beginning in 2008, the following amounts are used to determine the earned income credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income credit is allowed. The "threshold phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) at or above which no credit is allowed.

	Number of Qualifying Children		
Item	*One*	*Two or More*	*None*
Earned Income Amount	$ 8,580	$12,060	$ 5,720
Maximum Amount of Credit	$ 2,917	$ 4,824	$ 438
Threshold Phaseout Amount (Single, Surviving Spouse, or Head of Household)	$15,740	$15,740	$ 7,160
Completed Phaseout Amount (Single, Surviving Spouse, or Head of Household)	$33,995	$38,646	$12,880
Threshold Phaseout Amount (Married Filing Jointly)	$18,740	$18,740	$10,160
Completed Phaseout Amount (Married Filing Jointly)	$36,995	$41,646	$15,880

The instructions for the Form 1040 series provide tables showing the amount of the earned income credit for each type of taxpayer.

(2) *Excessive investment income*. For taxable years beginning in 2008, the earned income tax credit is not allowed under § 32(i) if the aggregate amount of certain investment income exceeds $2,950.

.08 *Low-Income Housing Credit*. For calendar year 2008, the amount used under § 42(h)(3)(C)(ii) to calculate the State housing credit ceiling for the low-income housing credit is the greater of (1) $2.00 multiplied by the State population, or (2) $2,325,000.

.09 *Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax."* For taxable years beginning in 2008, for a child to whom the § 1(g) "kiddie tax" applies, the exemption amount under §§ 55 and 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (1) the child's earned income for the taxable year, plus (2) $6,400.

.10 *Transportation Mainline Pipeline Construction Industry Optional Expense Substantiation Rules for Payments to Employees under Accountable Plans*. For calendar year 2008, an eligible employer may pay certain welders and heavy equipment mechanics an amount of up to $15 per hour for rig-related expenses that is deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002–41. If the employer provides fuel or otherwise reimburses fuel expenses, up to $9 per hour is deemed substantiated if paid under Rev. Proc. 2002–41.

.11 *Standard Deduction*.

(1) *In general*. For taxable years beginning in 2008, the standard deduction amounts under § 63(c)(2) are as follows:

Filing Status	*Standard Deduction*
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$10,900
Heads of Households (§ 1(b))	$ 8,000
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$ 5,450
Married Individuals Filing Separate Returns (§ 1(d))	$ 5,450

(2) *Dependent*. For taxable years beginning in 2008, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of (1) $900, or (2) the sum of $300 and the individual's earned income.

(3) *Aged or blind*. For taxable years beginning in 2008, the additional standard deduction amount under § 63(f) for the aged or the blind is $1,050. These amounts are increased to $1,350 if the individual is also unmarried and not a surviving spouse.

.12 *Overall Limitation on Itemized Deductions*. For taxable years beginning in 2008, the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is $159,950 (or $79,975 for a separate return filed by a married individual).

.13 *Qualified Transportation Fringe*. For taxable years beginning in 2008, the monthly limitation under § 132(f)(2)(A), regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass, is $115. The monthly limitation under § 132(f)(2)(B), regarding the fringe benefit exclusion amount for qualified parking, is $220.

.14 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses*. For taxable years beginning in 2008, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $100,650 for joint returns and $67,100 for other returns. The exclusion is completely phased out for modified adjusted gross income of $130,650 or more for joint returns and $82,100 or more for other returns.

.15 *Adoption Assistance Programs*. For taxable years beginning in 2008, under § 137(a)(2) the amount that can be excluded from an employee's gross income for the adoption of a child with special needs is $11,650. For taxable years beginning in 2008, under § 137(b)(1) the maximum amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished pursuant to an adoption assistance program for other adoptions by the employee is $11,650. The amount excludable from an employee's gross income begins to phase out under § 137(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $174,730 and is completely phased out for taxpayers with modified adjusted gross income of $214,730 or more. (See section 3.03 of this revenue procedure for the adjusted items relating to the adoption credit.)

.16 *Private Activity Bonds Volume Cap*. For calendar year 2008, the amounts used under § 146(d)(1) to calculate the State ceiling for the volume cap for private activity bonds is the greater of (1) $85 multiplied by the State population, or (2) $262,095,000.

.17 *General Arbitrage Rebate Rules*. For bond years ending in 2008, the amount of the computation credit determined under § 1.148–3(d)(4) of the proposed Income Tax Regulations is $1,430.

.18 *Safe Harbor Rules for Broker Commissions on Guaranteed Investment Contracts or Investments Purchased for a Yield Restricted Defeasance Escrow*. For calendar year 2008, under § 1.148–5(e)(2)(iii)(B)(*1*), a broker's commission or similar fee for the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable if (1) the amount of the fee that the issuer treats as a qualified administrative cost does not exceed the lesser of (A) $34,000, and (B) 0.2 percent of the computational base (as defined in § 1.148–5(e)(2)(iii)(B)(*2*)) or,

if more, $3,000; and (2) the issuer does not treat more than $95,000 in brokers' commissions or similar fees as qualified administrative costs for all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

.19 *Personal Exemption.*

(1) *Exemption amount.* For taxable years beginning in 2008, the personal exemption amount under § 151(d) is $3,500. The exemption amount for taxpayers with adjusted gross income in excess of the maximum phaseout amount is $2,333 for taxable years beginning in 2008.

(2) *Phaseout.* For taxable years beginning in 2008, the personal exemption amount begins to phase out at, and reaches the maximum phaseout amount after, the following adjusted gross income amounts:

Filing Status	*AGI – Beginning of Phaseout*	*AGI – Maximum Phaseout*
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$239,950	$362,450
Heads of Households (§ 1(b))	$199,950	$322,450
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$159,950	$282,450
Married Individuals Filing Separate Returns (§ 1(d))	$119,975	$181,225

.20 *Election to Expense Certain Depreciable Assets.* For taxable years beginning in 2008, under § 179(b)(1) the aggregate cost of any § 179 property a taxpayer may elect to treat as an expense can not exceed $128,000. Under § 179(b)(2), the $128,000 limitation is reduced (but not below zero) by the amount by which the cost of § 179 property placed in service during the 2008 taxable year exceeds $510,000.

.21 *Eligible Long-Term Care Premiums.* For taxable years beginning in 2008, the limitations under § 213(d)(10), regarding eligible long-term care premiums includible in the term "medical care," are as follows:

Attained Age Before the Close of the Taxable Year	*Limitation on Premiums*
40 or less	$ 310
More than 40 but not more than 50	$ 580
More than 50 but not more than 60	$1,150
More than 60 but not more than 70	$3,080
More than 70	$3,850

.22 *Retirement Savings.*

(1) For taxable years beginning in 2008, the applicable dollar amount under § 219(g)(3)(B)(i) for taxpayers filing a joint return is $85,000. If the taxpayer's spouse is not an active participant, the applicable dollar amount for the spouse under § 219(g)(3)(B)(i) is $159,000 for taxable years beginning in 2008.

(2) For taxable years beginning in 2008, the applicable dollar amount under § 219(g)(3)(B)(ii) for all other taxpayers (except for married taxpayers filing separately) is $53,000.

(3) The applicable dollar amount under § 219(g)(3)(B)(iii) for married taxpayers filing separately is $0.

.23 *Medical Savings Accounts.*

(1) *Self-only coverage.* For taxable years beginning in 2008, the term "high deductible health plan" as defined in § 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than $1,950 and not more than $2,900, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $3,850.

(2) *Family coverage.* For taxable years beginning in 2008, the term "high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $3,850 and not more than $5,800, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $7,050.

.24 *Interest on Education Loans.* For taxable years beginning in 2008, the $2,500 maximum deduction for interest paid on qualified education loans under § 221 begins to phase out under § 221(b)(2)(B) for taxpayers with modified adjusted gross income in excess of $55,000 ($115,000 for joint returns), and is completely phased out for taxpayers with modified adjusted gross income of $70,000 or more ($145,000 or more for joint returns).

.25 *Roth IRAs.*

(1) For taxable years beginning in 2008, the applicable dollar amount under § 408A(c)(3)(C)(ii)(I) for taxpayers filing a joint return is $159,000.

(2) For taxable years beginning in 2008, the applicable dollar amount under § 408A(c)(3)(C)(ii)(II) for all other taxpayers (except for married taxpayers filing separately) is $101,000.

(3) The applicable dollar amount under § 408A(c)(3)(C)(ii)(III) for married taxpayers filing separately is $0.

.26 *Treatment of Dues Paid to Agricultural or Horticultural Organizations.* For taxable years beginning in 2008, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $139.

.27 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns.*

(1) *Low cost article.* For taxable years beginning in 2008, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a "low cost article" of $9.10 or less.

(2) *Other insubstantial benefits.* For taxable years beginning in 2008, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90–12, 1990–1 C.B. 471 (as amplified by Rev. Proc. 92–49, 1992–1 C.B. 987, and modified by Rev. Proc. 92–102, 1992–2 C.B. 579), for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under § 170, are $9.10, $45.50, and $91, respectively.

.28 *Funeral Trusts.* For a contract entered into during calendar year 2008 for a "qualified funeral trust," as defined in § 685, the trust may not accept aggregate contributions by or for the benefit of an individual in excess of $9,000.

.29 *Expatriation to Avoid Tax.* For calendar year 2008, an individual with "average annual net income tax" of more than $139,000 for the five taxable years ending before the date of the loss of United States citizenship under § 877(a)(2)(A) is subject to tax under § 877(b).

.30 *Foreign Earned Income Exclusion.* For taxable years beginning in 2008, the foreign earned income exclusion amount under § 911(b)(2)(D)(i) is $87,600.

.31 *Valuation of Qualified Real Property in Decedent's Gross Estate.* For an estate of a decedent dying in calendar year 2008, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A for purposes of the estate tax can not exceed $960,000.

.32 *Annual Exclusion for Gifts.*

(1) For calendar year 2008, the first $12,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2008, the first $128,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.33 *Tax on Arrow Shafts.* For calendar year 2008, the tax imposed under § 4161(b)(2)(A) on the first sale by the manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows is $0.43 per shaft.

.34 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures.* For taxable years beginning in 2008, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98–19, 1998–1 C.B. 547), regarding certain exempt organizations with nondeductible lobbying expenditures, is $97 or less.

.35 *Notice of Large Gifts Received from Foreign Persons.* For taxable years beginning in 2008, recipients of gifts from certain foreign persons may be required to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds $13,561.

.36 *Persons Against Whom a Federal Tax Lien Is Not Valid.* For calendar year 2008, a federal tax lien is not valid against (1) certain purchasers under § 6323(b)(4) who purchased personal property in a casual sale for less than $1,320, or (2) a mechanic's lienor under § 6323(b)(7) that repaired or improved certain residential property if the contract price with the owner is not more than $6,600.

.37 *Property Exempt from Levy.* For calendar year 2008, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) can not exceed $7,900. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) can not exceed $3,950.

.38 *Interest on a Certain Portion of the Estate Tax Payable in Installments.* For an estate of a decedent dying in calendar year 2008, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is $1,280,000.

.39 *Attorney Fee Awards.* For fees incurred in calendar year 2008, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is $170 per hour.

.40 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts.* For calendar year 2008, the stated dollar amount of the *per diem* limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $270.

SECTION 4. EFFECTIVE DATE

.01 *General Rule.* Except as provided in section 4.02, this revenue procedure applies to taxable years beginning in 2008.

.02 *Calendar Year Rule.* This revenue procedure applies to transactions or events occurring in calendar year 2008 for purposes of sections 3.08 (low-income housing credit), 3.10 (transportation mainline pipeline construction industry optional expense substantiation rules for payments to employees under accountable plans), 3.16 (private activity bond volume cap), 3.17 (general arbitrage rebate rules), 3.18 (safe harbor rules for broker commissions on guaranteed investment contracts or investments purchased for a yield restricted defeasance escrow), 3.28 (funeral trusts), 3.29 (expatriation to avoid tax), 3.31 (valuation of qualified real property in decedent's gross estate), 3.32 (annual exclusion for gifts), 3.33 (tax on arrow shafts), 3.36 (persons against whom a federal tax lien is not valid), 3.37 (property exempt from levy), 3.38 (interest on a certain portion of the estate tax payable in installments), 3.39 (attorney fee awards), and 3.40 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Marnette M. Myers of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Myers at (202) 622–4920 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Regulations Governing Practice Before the Internal Revenue Service

REG–138637–07

AGENCY: Office of the Secretary, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed modifications of the regulations governing practice before the IRS (Circular 230). These proposed regulations affect individuals who practice before the IRS. The proposed amendments modify §10.34 of Circular 230 relating to standards with respect to tax returns.

DATES: Written or electronic comments and requests for a public hearing must be received by October 26, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–138637–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–138637–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–138637–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Matthew S. Cooper at (202) 622–4940; concerning submissions of comments and request for a public hearing, Kelly Banks of the Publications and Regulation Branch at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to §10.34 of Circular 230. Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department. Pursuant to section 330 of title 31, the Secretary has published the regulations in Circular 230 (31 CFR part 10).

On May 25, 2007, the President signed into law the Small Business and Work Opportunity Tax Act of 2007, Public Law 110–28 (121 Stat. 190), which amended several provisions of the Internal Revenue Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the penalties for preparing a return that reflects an understatement of liability, and increase applicable penalties. On June 11, 2007, the IRS released Notice 2007–54, 2007–27 I.R.B. 12 (see §601.601(d)(2)(ii)(*b*)), providing guidance and transitional relief for the return preparer provisions under section 6694 of the Internal Revenue Code, as recently amended.

Final regulations (T.D. 9359) are, simultaneously to these proposed regulations, being promulgated on September 26, 2007, modifying the general standards of practice before the IRS under Circular 230. Those final regulations finalize the standards with respect to documents, affidavits and other papers as proposed, with modifications. Those final regulations, however, do not finalize the standards with respect to tax returns under §10.34(a) and the definitions under §10.34(e) because of the amendments made by the Small Business and Work Opportunity Tax Act of 2007. Rather, the Treasury Department and the IRS are reserving §10.34(a) and (e) in those final regulations and are simultaneously issuing this notice of proposed rulemaking proposing to amend this part to reflect these recent amendments to the Code.

The Treasury Department and the IRS have determined that the professional standards under §10.34 of Circular 230 should conform with the civil penalty standards for return preparers. Previously, for example, on June 20, 1994 (T.D. 8545, 1994–2 C.B. 415 [59 FR 31523]), the regulations were modified to reflect more closely the rules under section 6694 and professional guidelines. The standards with respect to tax returns in §10.34(a) of these proposed regulations have been amended to reflect changes to section 6694(a) of the Internal Revenue Code made by the Small Business and Work Opportunity Tax Act of 2007.

Under §10.34(a) of these proposed regulations, a practitioner may not sign a tax return as a preparer unless the practitioner has a reasonable belief that the tax treatment of each position on the return would more likely than not be sustained on its merits, or there is a reasonable basis for each position and each position is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless (1) the practitioner has a reasonable belief that the position satisfies the more likely than not standard; or (2) the position has a reasonable basis and is adequately disclosed to the Internal Revenue Service. The definitions of "more likely than not" and "reasonable basis" under §10.34(e) also are proposed to be amended to reflect these changes in accordance with the well-established definitions of these terms under the section 6662 penalty regulations.

On June 11, 2007, the IRS released Notice 2007–54, 2007–27 I.R.B. 12 (see §601.601(d)(2)(ii)(*b*)), providing guidance and transitional relief for the return preparer provisions under section 6694 of

the Code, as recently amended. In order to apply §10.34 of these regulations consistently with the transitional relief under Notice 2007–54, §10.34(a) and (e) are proposed to apply to returns filed or advice provided on or after the date that final regulations are published in the **Federal Register**, but no earlier than January 1, 2008.

Proposed Effective Date

These regulations are proposed to apply to returns filed or advice provided on or after the date that final regulations are published in the **Federal Register**, but no earlier than January 1, 2008.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified, under the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et. seq.*), that these regulations will not have a significant economic impact on a substantial number of small entities. Persons authorized to practice have long been required to comply with certain standards of conduct when practicing before the Internal Revenue Service. The general requirements of these regulations are substantially the same as the recent Congressional amendments to section 6694 of the Code by the Small Business and Work Opportunity Tax Act of 2007. Practitioners already enroll in educational seminars or training programs to keep up to date with the latest changes to the Internal Revenue Code, the provisions of the Act, and Circular 230, and the proposed regulations will generally be covered as part of that training. These regulations will not impose, or otherwise cause, a significant increase in reporting, recordkeeping, or other compliance burdens on a substantial number of small entities. A regulatory flexibility analysis, therefore, is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the regulations' impact on small businesses.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the substance of the proposed regulations, as well as on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Matthew S. Cooper of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 31 CFR part 10 is proposed to be amended to read as follows:

PART 10 — PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Paragraph 1. The authority citation for 31 CFR part 10 continues to read as follows:

Authority: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 *et. seq.*; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., p. 1017.

Par. 2. Section 10.34(a) and (e) are added and paragraph (f) is revised to read as follows:

§10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) *Tax returns.* A practitioner may not sign a tax return as a preparer unless the practitioner has a reasonable belief that the tax treatment of each position on the return would more likely than not be sustained on its merits (the more likely than not standard), or there is a reasonable basis for each position and each position is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless—

(1) The practitioner has a reasonable belief that the position satisfies the more likely than not standard; or

(2) The position has a reasonable basis and is adequately disclosed to the Internal Revenue Service.

* * * * *

(e) *Definitions.* For purposes of this section—

(1) *More likely than not.* A practitioner is considered to have a reasonable belief that the tax treatment of a position is more likely than not the proper tax treatment if the practitioner analyzes the pertinent facts and authorities, and based on that analysis reasonably concludes, in good faith, that there is a greater than fifty-percent likelihood that the tax treatment will be upheld if the IRS challenges it. The authorities described in 26 CFR 1.6662–4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis.

(2) *Reasonable basis.* A position is considered to have a reasonable basis if it is reasonably based on one or more of the authorities described in 26 CFR 1.6662–4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations. Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. The possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

(3) *Frivolous.* A position is frivolous if it is patently improper.

(f) *Effective/applicability date.* Section 10.34(a) and (e) is applicable for returns filed or advice provided on or after the date that final regulations are published in

the **Federal Register**, but no earlier than January 1, 2008.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved September 19, 2007.

Robert Hoyt,
General Counsel, Office of the Secretary.

(Filed by the Office of the Federal Register on September 25, 2007, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2007, 72 F.R. 54621)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-104

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007

Name	Address	Designation	Date of Reinstatement
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007

Name	Address	Designation	Date of Suspension
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007

Name	Address	Designation	Date of Suspension
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007

Name	Address	Designation	Date of Suspension
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007

Name	Address	Designation	Effective Date
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–105

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on November 5, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Gregory and Vickie Iverson Charitable Supporting Organization
Salt Lake City, UT

The Scott Canepa Charitable Supporting Organization
Las Vegas, NV

Kyle Charitable Support Organization Trust
Austin, TX

Paul and Deborah Marvin Charitable Supporting Foundation
Salt Lake City, UT

Malecha Family Foundation
Apple Valley, MN

Shared Visions Foundation
Park City, UT

Harold B Lee Foundation
Woodland, UT

Missouri Basketball Club
Columbia, MO

Mahisekar Charitable Supporting Organization
Orland Park, IL

Georgetown Title Foundation
Sandy, UT

Buddy & Rita Gregory Charitable Supporting Organization
Lehi, UT

Keith & Anna Barton Charitable Supporting Organization
Lehi, UT

Asafo Global Trust Fund, Inc.
Phoenix, AZ

White Wing Educational Dev Corp
New York, NY

AARO Credit Services
Costa Mesa, CA

Paul and Deborah Manning Charitable Supporting Org
Salt Lake City, UT

MOP Non-Profit, Inc.
Sterling Heights, MI

Access Home Project, Inc.
Los Angeles, CA

To Life Foundation
New York, NY

Miami Latin Film Festival
Miami, FL

Larry and Kelli Cotton Charitable Supporting Organization
Fort Worth, TX

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1346.—Recovery of Unconstitutional Federal Taxes

The Supreme Court holds that the Trust missed section 7426(a)(1)'s deadline for challenging a levy, and may not bring the challenge as a tax refund claim under section 1346(a)(1). See Court Decision 2083, page 986.

Section 7426.—Civil Actions by Persons Other Than Taxpayers

Ct. D. 2083

SUPREME COURT OF THE UNITED STATES

No. 05–1541 (2007)

EC TERM OF YEARS TRUST *v.* UNITED STATES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

April 30, 2007

Syllabus

Under 26 U.S.C. §7426(a)(1), if the Internal Revenue Service (IRS) levies upon a third party's property to collect taxes owed by another, the third party may bring a wrongful levy action against the United States, so long as such action is brought before "the expiration of 9 months from the date of the levy," §6532(c)(1). In contrast, the limitations period for a tax refund action under 28 U.S.C. §1346(a)(1) begins with an administrative claim that may be filed within at least two years, and may be brought to court within another two years after an administrative denial. The IRS levied on a bank account in which petitioner (Trust) had deposited funds because the IRS assumed that the Trust's creators had transferred assets to the Trust to evade taxes. The bank responded with a check to the Treasury. Almost a year later, the Trust and others brought a §7426(a)(1) action claiming wrongful levies, but the District Court dismissed the complaint because it was filed after the 9-month limitations period had expired. After unsuccessfully pursing a tax refund at the administrative level, the Trust filed a refund action under §1346(a)(1). The District Court held that a wrongful levy claim under §7426(a)(1) was the sole remedy possible and dismissed, and the Fifth Circuit affirmed.

Held: The Trust missed §7426(a)(1)'s deadline for challenging a levy, and may not bring the challenge as a tax refund claim under §1346(a)(1). Section 7426(a)(1) provides the exclusive remedy for third-party wrongful levy claims. "[A] precisely drawn, detailed statute pre-empts more general remedies," *Brown v. GSA*, 425 U.S. 820, 834, and it braces the preemption claim when resort to a general remedy would effectively extend the limitations period for the specific one, see *id.* at 833. If third parties could avail themselves of §1346(a)(1)'s general tax refund jurisdiction, they could effortlessly evade §7426(a)(1)'s much shorter limitations period. The Trust argues that because *United States v. Williams*, 514 U.S. 527, construed §1346(a)(1)'s general jurisdictional grant expansively enough to cover third parties' wrongful levy claims, treating §7426(a)(1) as the exclusive avenue for these claims would amount to a disfavored holding that §7426(a)(1) implicitly repealed §1346(a)(1)'s pre-existing jurisdictional grant. But this reads *Williams* too broadly. *Williams* involved a lien and was decided on the specific understanding that no other remedy was open to the plaintiff. Here, the Trust challenges a levy and could have made a timely claim under §7426(a)(1). Even if the presumption against implied repeals applied here, §7426(a)(1)'s 9-month limitations period cannot be reconciled with the notion that the same challenge would be open under §1346(a)(1) for up to four years. Nor can the two statutory schemes be harmonized by construing §7426(a)(1)'s filing deadline to cover only those actions seeking pre-deprivation remedies unavailable under §1346(a)(1). On its face, §7426(a)(1) applies to pre-deprivation and post-deprivation claims alike. Pp. 4–7.

434 F.3d 807 affirmed.

STEVENS, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 05–1541 (2007)

EC TERM OF YEARS TRUST *v.* UNITED STATES

On WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

April 30, 2007

JUSTICE STEVENS delivered the opinion of the Court.

This is a challenge to the Internal Revenue Service's levy upon the property of a trust, to collect taxes owed by another, an action specifically authorized by 26 U.S.C. §7426(a)(1), but subject to a statutory filing deadline the trust missed. The question is whether the trust may still challenge the levy through an action for tax refund under 28 U.S.C. §1346(a)(1). We hold that it may not.

I

The Internal Revenue Code provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." 26 U.S.C. §6321. "A federal tax lien, however, is not self-executing," and the IRS must take "[a]ffirmative action . . . to enforce collection of the unpaid taxes." *United States v. National Bank of Commerce*, 472 U.S. 713, 720 (1985). One of its "principal tools," *ibid.*, is a levy, which is a "legally sanctioned seizure and sale of property," Black's Law Dictionary 926 (8th ed. 2004); see also §6331(b) ("The term 'levy' as used in this title includes the power of distraint and seizure by any means").

To protect against a "'wrongful'" imposition upon "property which is not the taxpayer's," S. Rep. No. 1708, 89th Cong., 2d Sess., 30 (1966), the Federal Tax Lien Act of 1966 added §7426(a)(1), providing that "[i]f a levy has been made on property . . . any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in . . . such property and that such property was wrongfully levied upon may bring a civil action against the United States in a district court. 80 Stat. 1143. The action must, however, be brought before "the expiration of 9 months from the date of the levy."[1] §6532(c)(1). This short limitations period contrasts with its counterpart in a tax refund action under 28 U.S.C. §1346(a)(1), which begins with an administrative claim that may be filed within at least two years, and may be brought to court within another two after an administrative denial.[2] The demand for greater haste when a third party contests a levy is no accident; as the Government explained in the hearings before passage of the Act, "[s]ince after seizure of property for nonpayment of taxes [an IRS] district director is likely to suspend further collection activities against the taxpayer, it is essential that he be advised promptly if he has seized property which does not belong to the taxpayer. Hearings on H.R. 11256 and H.R. 11290 before the House Committee on Ways and Means, 89th Cong., 2d Sess., 57–58 (1966) (written statement of Stanley S. Surrey, Assistant Secretary of the Treasury); see also *id.* at 72 (statement of Laurens Williams, Chairman, Special Committee on Federal Liens, American Bar Association) ("A short (9-month) statute of limitations is provided, because it is important to get such controversies decided quickly so the Government may pursue the taxpayer's own property if it made a mistake the first time").

II

After Elmer W. Cullers, Jr., and Dorothy Cullers established the EC Term of Years Trust in 1991, the IRS assessed federal tax liabilities against them for what the Government claimed (and the Trust does not dispute, see Tr. of Oral Arg. 7) were unwarranted income tax deductions in the 1980s. The Government assumed that the Cullerses had transferred assets to the Trust to evade taxes, and so filed a tax lien against the Trust in August 1999. The Trust denied any obligation, but for the sake of preventing disruptive collection efforts by the IRS, it deposited funds in a bank account, against which the IRS issued a notice of levy to the bank in September 1999. In October, the bank responded with a check for over $3 million to the United States Treasury.

Almost a year after that, the Trust (joined by several other trusts created by the Cullerses) brought a civil action under 26 U.S.C. §7426(a)(1) claiming wrongful levies, but the District Court dismissed it because the complaint was filed after the 9-month limitations period had expired, see §6532(c)(1). The court also noted that tax refund claims under 28 U.S.C. §1346(a)(1) were not open to the plaintiff trusts because §7426 "'affords the exclusive remedy for an innocent third party whose property is confiscated by the IRS to satisfy another person's tax liability.'" *BSC Term of Years Trust v. United States*, 2001–1 USTC ¶50,174, p. 87,237, n. 1, 87 AFTR 2d ¶2001–390, p. 2001–547, n. 1 (WD Tex., 2000) (quoting *Texas Comm. Bank Fort Worth, N.A. v. United States*, 896 F.2d 152, 156 (CA5 1990); emphasis deleted). At first the Trust sought review by the Court of Appeals for the Fifth Circuit, but then voluntarily dismissed its appeal. *BSC Term of Years Trust v. United States*, 87 AFTR 2d ¶2001–1039, p. 2001–2532 (2001).

After unsuccessfully pursuing a tax refund at the administrative level, the Trust filed a second action, this one for a refund under §1346(a)(1). The District Court remained of the view that a claim for a wrongful levy under §7426(a)(1) had been the sole remedy possible and dismissed.[3] The Court of Appeals for the Fifth Circuit affirmed.

Because the Ninth Circuit, on the contrary, has held that §7426(a)(1) is not the exclusive remedy for third parties challenging a levy, see *WWSM Investors v. United States*, 64 F.3d 456 (1995), we granted certiorari to resolve the conflict, 549 U.S. ___ (2006). We affirm.

III

"In a variety of contexts, the Court has held that a precisely drawn, detailed statute pre-empts more general remedies." *Brown v. GSA*, 425 U.S. 820, 834 (1976); see *Block v. North Dakota ex rel. Board of Univ. and School Lands*, 461 U.S. 273, 284–286 (1983) (adverse claimants to real property of the United States may not rely on "officer's suits" or on other general remedies because the Quiet Title Act of 1972 is their exclusive recourse); see also *Stonite Products Co. v. Melvin Lloyd Co.*, 315 U.S. 561 (1942) (venue in patent infringement cases is governed by a statute dealing specifically with patents, not a general venue provision). It braces the preemption claim when resort to a general remedy would effectively extend the limitations period for the specific one. See *Brown v. GSA*, *supra*, at 833 (rejecting an interpretation that would "driv[e] out of currency" a narrowly aimed provision "with its rigorous . . . time limitations" by permitting "access to the courts under other, less demanding statutes"); see also *Rancho Palos Verdes v. Abrams*, 544 U.S. 113, 122–123 (2005) (concluding that 47 U.S.C. §332(c) precludes resort to the general cause of action under 42 U.S.C. §1983, in part because §332 "limits relief in ways that §1983 does not" by requiring judicial review to be sought within 30 days); 544 U.S. at 130, n. (STEVENS, J., concurring in judgment) (same).

Resisting the force of the better-fitted statute requires a good countervailing reason, and none appears here. Congress specifically tailored §7426(a)(1) to third-party claims of wrongful levy, and if third parties could avail themselves of the general tax refund jurisdiction of §1346(a)(1), they could effortlessly evade

[1] This period can be extended for up to 12 months if the third party makes an administrative request for the return of the property wrongfully levied upon. See 26 U.S.C. §6532(c)(2).

[2] Title 28 U.S.C. §1346(a)(1) gives district courts "jurisdiction, concurrent with the United States Court of Federal Claims," over "[a]ny civil action against the United States for the recovery of," among other things, "any internal revenue tax alleged to have been erroneously or illegally assessed or collected." A taxpayer may bring such an action within two years after the IRS disallows the taxpayer's administrative refund claim. See 26 U.S.C. Secs. 6532(a)(1)–(2); see also §7422(a) (requiring a taxpayer to file the administrative claim before seeking a refund in court). An administrative refund claim must, in turn, be filed within two years from the date the tax was paid or three years from the time the tax return was filed, whichever is later. See §6511(a).

[3] The District Court declined to dismiss the Trust's claim on res judicata grounds, and the Government does not argue claim or issue preclusion in this Court, see Brief for United States 5, n. 2.

the levy statute's 9-month limitations period thought essential to the Government's tax collection.

The Trust argues that in *United States v. Williams*, 514 U.S. 527 (1995), we construed the general jurisdictional grant of §1346(a)(1) expansively enough to cover third parties' wrongful levy claims. So, according to the Trust, treating §7426(a)(1) as the exclusive avenue for these claims would amount to a disfavored holding that §7426(a)(1) implicitly repealed the pre-existing jurisdictional grant of §1346(a)(1). See *Radzanower v. Touche Ross & Co.*, 426 U.S. 148 (1976); *Morton v. Mancari*, 417 U.S. 535 (1974).

But the Trust reads *Williams* too broadly. Although we decided that §1346(a)(1) authorizes a tax-refund claim by a third party whose property was subjected to an allegedly wrongful tax lien, we so held on the specific understanding that no other remedy, not even a timely claim under §7426(a)(1), was open to the plaintiff in that case. See *Williams*, *supra*, at 536–538. Here, on the contrary, the Trust challenges a levy, not a lien, and could have made a timely claim under §7426(a)(1) for the relief it now seeks under §1346(a)(1).[4]

And even if the canon against implied repeals applied here, the Trust still could not prevail. We simply cannot reconcile the 9-month limitations period for a wrongful levy claim under §7426(a)(1) with the notion that the same challenge would be open under §1346(a)(1) for up to four years. See *Posadas v. National City Bank*, 296 U.S. 497, 503 (1936) ("[W]here provisions in the two acts are in irreconcilable conflict, the later act to the extent of the conflict constitutes an implied repeal of the earlier one"). On this point, the Trust proposes that the two statutory schemes can be "harmonized" by construing the deadline for filing §7426(a)(1) claims to cover only those actions seeking "pre-deprivation" remedies unavailable under §1346(a)(1). See Reply Brief for Petitioner 6. But this reading would violate the clear text of §7426(a)(1), which on its face applies to pre-deprivation and post-deprivation claims alike. See 26 U.S.C. §7426(a)(1) ("Such action may be brought without regard to whether such property has been surrendered to or sold by the Secretary").

* * *

The Trust missed the deadline for challenging a levy under §7426(a)(1), and may not bring the challenge as a tax refund claim under §1346(a)(1). The judgment of the Court of Appeals is accordingly affirmed.

It is so ordered.

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[4] It has been commonly understood that Williams did not extend §1346(a)(1) to parties in the Trust's position. See 434 F.3d 807, 810 (CA5 2006) (case below) ("To construe Williams to allow an alternative remedy under §1346, with its longer statute of limitations period, would undermine the surety provided by the clear avenue to recovery under §7426" (citation omitted)); Dahn v. United States, 127 F.3d 1249, 1253 (CA10 1997) ("[T]here were no tax levies involved in [Williams]. Thus, the Court was concerned solely with the reach of §1346 per se; the exclusivity of a concurrent §7426 claim was never in issue. Indeed, the Court specifically emphasized the inapplicability of §7426 (or any other meaningful remedy) to reinforce its broad reading of §1346"); WWSM Investors v. United States, 64 F.3d 456, 459 (CA9 1995) (Brunetti, J., dissenting) ("The Supreme Court recognized Williams as a refund, not a wrongful levy, case, and [did not] even hint that §7426 was not the exclusive remedy for a claimed wrongful levy"); Rev.Rul. 2005–49, 2005–2 Cum.Bull. 126 ("The rationale in Williams is inapplicable to wrongful levy suits because, Congress created an exclusive remedy under section 7426 for third persons claiming an interest in property levied upon by the [IRS]"); but see WWSM Investors, supra, at 459 (majority opinion) ("[S]eizing money from WWSM's bank account is functionally equivalent to what the IRS did in Williams — placing a lien on property in escrow under circumstances which compelled Mrs. Williams to pay the IRS and discharge the lien").

Subpart A.—Tax Conventions and Other Related Items

US-UK Agreement Defining the Term "First Notification" Under Treaty Article 26(1)

Announcement 2007–107

The following is a copy of the Competent Authority Agreement ("the Agreement") entered into by the Competent Authorities of the United States and the United Kingdom regarding the definition of "first notification" under paragraph 1 of Article 26 (Mutual Agreement Procedure) of the Convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation with respect to taxes on income.

The text of the Agreement is as follows:

COMPETENT AUTHORITY AGREEMENT

The competent authorities of the United States and the United Kingdom hereby enter into the following agreement ("the Agreement") regarding the definition of "first notification" under paragraph 1 of Article 26 (Mutual Agreement Procedure) of the Convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation with respect to taxes on income signed at London on July 24, 2001 ("the Treaty"). The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure).

It is understood that for the purposes of the Agreement the term "Article" refers to an Article of the Treaty.

Definition of "First Notification" under Article 26(1)

Paragraph 1 of Article 26 provides that

> Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. The case must be presented within three years from the *first notification* of the action resulting in taxation not in accordance with the provisions of this Convention or, if later, within six years from the end of the taxable year or chargeable period in respect of which that taxation is imposed or proposed. [Emphasis added].

The competent authorities of the United States and the United Kingdom have agreed that paragraph 1 of Article 26 of the Convention shall be interpreted in the way most favourable to the taxpayer, consistent with the approach set out in the OECD commentary on the Model Tax Convention on Income and on Capital. In order to provide certainty for taxpayers and to ensure consistent application of the provision, the date of "first notification of the action resulting in taxation not in accordance with the Convention" shall be treated as the date when all domestic remedies have been exhausted.

In the United Kingdom, this will be either the date of issue of a statutory notice required to conclude an assessment and/or any related appeal procedures for the period of assessment in question, or a letter of acceptance by an officer of the Board of HM Revenue & Customs to settlement terms for the period in question.

In the United States, this will be the date of the later of: (1) an assessment pursuant to a notice of proposed adjustment or a statutory notice of deficiency; (2) when a closing agreement is accepted by the Secretary of the Treasury or his delegate; or (3) if the taxpayer is a party in an action in a US court regarding a redetermination of tax liability or requesting a refund of tax, when such action is finally resolved, including any appeal.

Upon signature by both Competent Authorities, this agreement shall have effect from the date of entry into force of the Convention, without regard to the taxable or chargeable period to which the matter relates.

Agreed to by the Undersigned competent authorities:

Date	Date
Frank Y. Ng U.S. Competent Authority	Diane Hay U.K. Competent Authority

Part III. Administrative, Procedural, and Miscellaneous

Notice of Additional 2008 Transition Relief under Section 409A

Notice 2007–86

SECTION 1. PURPOSE

This notice provides additional transition relief regarding the application of section 409A of the Internal Revenue Code to nonqualified deferred compensation plans. Generally, this notice extends to December 31, 2008, the transition relief that was scheduled to expire on December 31, 2007, as provided in Notice 2006–79, 2006–43 I.R.B. 763, and the preamble to the final regulations under section 409A (72 Fed. Reg. 19234 (April 17, 2007)) (the final regulations preamble). This transition relief revokes and supersedes the transition relief provided in § III of Notice 2007–78, 2007–41 I.R.B. 780, and modifies the relief provided in § IV of Notice 2007–78 related to employment agreements, as described below. This transition relief does not affect the guidance provided in § IV of Notice 2007–78 related to predetermined cashout features, or the guidance provided in § VI of Notice 2007–78, related to the application of section 409A(b) (restrictions on certain trusts and other arrangements).

SECTION 2. BACKGROUND

Section 409A provides certain requirements applicable to nonqualified deferred compensation plans. If a plan does not meet those requirements, participants in the plan are required to immediately include amounts deferred under the plan in income and pay additional taxes on such income. Beginning with Notice 2005–1, 2005–1 C.B. 274 , the Treasury Department and the IRS have issued several notices and other guidance providing transition relief intended to permit and promote compliance with the requirements of section 409A. The Treasury Department and the IRS also issued proposed regulations under section 409A (70 Fed. Reg. 57930 (Oct. 4, 2005)) (the proposed regulations), and final regulations under section 409A in April 2007 (the final regulations).

On September 10, 2007, the Treasury Department and the IRS issued Notice 2007–78, granting certain transition relief intended to facilitate compliance with the written plan requirements set forth in the final regulations. See §1.409A–1(c). Commentators stated that although the Notice 2007–78 transition relief was helpful, the transition relief in that notice did not adequately address the need for additional time for service recipients and service providers to analyze all of their plans and make informed and reasoned decisions regarding the changes that would be necessary to bring existing arrangements into compliance with the final regulations. This notice addresses these concerns by generally extending the transition relief currently scheduled to expire on December 31, 2007 through December 31, 2008. Section III of Notice 2007–78 is revoked and superseded by this notice.

SECTION 3. EXTENSION OF TRANSITION RELIEF

.01 Extension of Transition Relief Provided in Notice 2006–79

Section 3 of Notice 2006–79 is modified and superseded in accordance with paragraphs (A) and (B) of this § 3.01.

(A) *General rule.* During 2008, taxpayers are not required to comply with the requirements of the final regulations. Instead, they are required to operate a nonqualified deferred compensation plan in compliance with the plan's terms, to the extent consistent with section 409A and the applicable guidance (including Notice 2005–1). Where a provision of Notice 2005–1 is inconsistent with the final regulations, taxpayers may rely upon either Notice 2005–1 or the final regulations. To the extent an issue is not addressed in Notice 2005–1 or other applicable guidance, taxpayers must apply a reasonable, good faith interpretation of the statute. Reliance upon the final regulations is treated as applying a reasonable, good faith interpretation of the statute.

Taxpayers may not rely upon the provisions of the proposed regulations for periods after December 31, 2007, except that taxpayers may continue to rely on sections II.E and VI.E of the preamble to the proposed regulations (relating to the application of section 409A to partners and partnerships) until further guidance is issued and sections XI.C (relating to changes in payment elections or conditions) and XI.H (relating to substitutions of non-discounted stock options and stock appreciation rights for discounted stock options and stock appreciation rights) of the preamble to the proposed regulations continue to apply to the extent provided in § 3 of Notice 2006–79, as modified and superseded by paragraph (B) of this § 3.01.

(B) *Section 3 of Notice 2006–79 modified and superseded.*

(1) Paragraphs .01, .02, .03 and .04 of § 3 of Notice 2006–79 are modified and superseded to reflect the general rule provided in paragraph (A) and to read as follows:

.01. *Amendment and operation of plans adopted on or before December 31, 2008*

A plan adopted on or before December 31, 2008 will not be treated as violating section 409A(a)(2), (3) or (4) on or before December 31, 2008 if the plan is operated through December 31, 2008 in compliance with the provisions of section 409A and applicable provisions of Notice 2005–1 and any other generally applicable guidance published with an effective date prior to January 1, 2008, and the plan is amended on or before December 31, 2008 to conform to the provisions of section 409A and the final regulations under section 409A (70 Fed. Reg. 19234 (April 17, 2007)) with respect to amounts subject to section 409A. For such periods, to the extent an issue is not addressed in an applicable provision of Notice 2005–1 or other generally applicable guidance published with an effective date prior to January 1, 2008, the plan must be operated consistent with a good faith, reasonable interpretation of section 409A, and, to the extent not inconsistent therewith, the plan's terms. For purposes of this notice, "generally applicable guidance published with an effective date prior to January 1, 2008" does not include the final regulations.

Compliance with the proposed regulations is not required and compliance with the final regulations before January 1, 2009 is not required. However, for periods before January 1, 2008, compliance

with the proposed regulations or the final regulations will constitute reasonable, good faith compliance with the statute. For periods after December 31, 2007 and before January 1, 2009, compliance with the final regulations (but not the proposed regulations) will constitute reasonable, good faith compliance with the statute. To the extent that a provision of either the proposed regulations or the final regulations is inconsistent with a provision of Notice 2005–1, or a provision of the proposed regulations is inconsistent with a provision of the final regulations, for periods before January 1, 2008, the plan may comply with the provision of the proposed regulations, the final regulations or Notice 2005–1. To the extent that a provision of the final regulations is inconsistent with a provision of Notice 2005–1, after December 31, 2007 and before January 1, 2009, the plan may comply with the provision of the final regulations or Notice 2005–1.

A plan will not be operating in good faith compliance if discretion provided under the terms of the plan is exercised in a manner that causes the plan to fail to meet the requirements of section 409A. For example, if an employer retains the discretion under the terms of the plan to delay or extend payments under the plan in a manner that violates section 409A and exercises such discretion, the plan will not be considered to be operated in good faith compliance with section 409A with regard to any plan participant. However, an exercise of a right under the terms of the plan by a participant solely with respect to that participant's benefits under the plan, in a manner that causes the plan to fail to meet the requirements of section 409A, will not be considered to result in the plan failing to be operated in good faith compliance with respect to other participants. For example, the request for and receipt of an immediate payment permitted under the terms of the plan if the participant forfeits 20 percent of the participant's benefits (a haircut) will be considered a failure of the plan to meet the requirements of section 409A with respect to that participant, but not with respect to all other participants under the plan.

.02. *Change in payment elections or conditions on or before December 31, 2008*

The transition relief provided in section XI.C of the preamble to the proposed regulations generally continues to apply through December 31, 2008, with certain clarifications described below, and subject to limitations for certain discounted stock rights also described below. Accordingly, with respect to amounts subject to section 409A, a plan may provide, or be amended to provide, for new payment elections on or before December 31, 2008, with respect to both the time and form of payment of such amounts and the election or amendment will not be treated as a change in the time or form of payment under section 409A(a)(4) or an acceleration of a payment under section 409A(a)(3), provided that the plan is so amended and elections are made on or before December 31, 2008. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2006 and on or before December 31, 2006, the election or amendment may apply only to amounts that would not otherwise be payable in 2006 and may not cause an amount to be paid in 2006 that would not otherwise be payable in 2006. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2007 and on or before December 31, 2007, the election or amendment may apply only to amounts that would not otherwise be payable in 2007 and may not cause an amount to be paid in 2007 that would not otherwise be payable in 2007. With respect to an election or amendment to change a time and form of payment made on or after January 1, 2008 and on or before December 31, 2008, the election or amendment may apply only to amounts that would not otherwise be payable in 2008 and may not cause an amount to be paid in 2008 that would not otherwise be payable in 2008. So, for example, where an amount would otherwise be payable upon an event, such as a separation from service, an election in 2008 cannot change the amount that would be payable in 2008 if the service provider separated from service in 2008. In addition, a deferral election may be made with respect to an amount that is a short-term deferral within the meaning of proposed §1.409A–1(b)(4), provided that the election is made before January 1, 2008 and before the year in which the amount would otherwise have been paid. Also, a deferral election may be made with respect to an amount that is a short-term deferral within the meaning of final §1.409A–1(b)(4), provided that the election is made before January 1, 2009 and before the year in which the amount would otherwise have been paid.

This provision applies to elections or amendments by a service provider, a service recipient, or both a service provider and a service recipient. A service provider or service recipient may make more than one change or amendment under this relief, provided that each such change or amendment is made in accordance with the deadlines and conditions set forth in the applicable transition relief. For example, a service provider that in 2005 elected to change the time and form of payment of deferred compensation to a lump sum payment in 2010, may elect again in 2006, 2007 or 2008 to change the time and form of payment in accordance with this paragraph. However, a service provider that in 2005 elected to be paid an amount in 2008 (and that did not change such election in 2006 or 2007) may not in 2008 change the time and form of payment to be paid in a later year.

Similarly, except as provided below with respect to certain discounted stock rights, an outstanding stock right that provides for a deferral of compensation subject to section 409A may be amended to provide for fixed payment terms consistent with section 409A, or to permit holders of such rights to elect fixed payment terms consistent with section 409A, and such amendment or election will not be treated as a change in the time and form of payment under section 409A(a)(4) or an acceleration of a payment under section 409A(a)(3), provided that the option or right is so amended, and any elections are made, on or before December 31, 2008. For this purpose, a stock right will not be treated as payable in a year solely because the stock right is exercisable during that year, if the stock right is also reasonably expected to be exercisable in a subsequent year.

.03 *Payments linked to qualified plans and certain other plans*

The ability to link a payment election under a nonqualified deferred compensation plan to an election under a qualified plan is extended through 2008. In addition, this relief is extended to payment elections under nonqualified deferred compensation plans that are linked to certain additional employer plans, including section 403(b)

annuities, section 457(b) eligible plans, and certain foreign broad-based plans. Accordingly, (i) for periods ending on or before December 31, 2007, an election as to the time and form of a payment under a nonqualified deferred compensation plan that is controlled by a payment election made by the service provider or beneficiary of the service provider under a qualified employer plan described in proposed or final §1.409A–1(a)(2), a plan that includes a trust described in section 402(d), a plan described in section 1022(i)(1) or (2) of the Employee Retirement Income Security Act, or a foreign broad-based plan described in proposed or final §1.409A–1(a)(3)(v), will not violate the requirements of section 409A, provided that the determination of the time and form of the payment is made in accordance with the terms of the nonqualified deferred compensation plan that govern payment elections, as in effect on October 3, 2004 and (ii) for periods ending after December 31, 2007 and before January 1, 2009, the rules discussed in (i) will be applied by reference to the provisions of the final regulations only. For example, where a nonqualified deferred compensation plan provides as of October 3, 2004, that the time and form of payment to a service provider or beneficiary will be the same time and form of payment elected by the service provider or beneficiary under a qualified plan, it will not be a violation of section 409A for the plan administrator to make or commence payments under the nonqualified deferred compensation plan on or after January 1, 2005, and on or before December 31, 2008, pursuant to the payment election under the qualified plan. Notwithstanding the foregoing, other provisions of the Internal Revenue Code and common law tax doctrines continue to apply to any election as to the time and form of a payment under a nonqualified deferred compensation plan.

.04 *Substitutions of non-discounted stock options and stock appreciation rights for discounted stock options and stock appreciation rights*

Notice 2005–1, Q&A–18(d) provides that it will not be a material modification to replace a stock option or stock appreciation right otherwise providing for a deferral of compensation under section 409A with a stock option or stock appreciation right that would not have constituted a deferral of compensation under section 409A if it had been granted upon the original date of grant of the replaced stock option or stock appreciation right, provided that the cancellation and reissuance occurs on or before December 31, 2005. Section XI.H of the preamble to the proposed regulations extended the period during which the cancellation and reissuance may occur until December 31, 2006, but only to the extent a cancellation and reissuance in 2006 does not result in the cancellation of a deferral in exchange for cash or vested property in 2006. Except with respect to certain discounted stock rights described in § 3.07 of Notice 2006–79, the period during which the cancellation and reissuance may occur is extended until December 31, 2008, but only to the extent such cancellation and reissuance in 2007 does not result in the cancellation of a deferral in exchange for cash or vested property in 2007 and only to the extent such cancellation and reissuance in 2008 does not result in the cancellation of a deferral in exchange for cash or vested property in 2008. For example, a discounted option generally may be replaced through December 31, 2008 with an option that would not have provided for a deferral of compensation, although the exercise of such a discounted option after 2005 and before the cancellation and replacement generally would result in a violation of section 409A unless such exercise complied in operation with the requirements of section 409A and the applicable guidance.

Where replacement stock options or stock appreciation rights that would not constitute deferred compensation subject to section 409A are issued in accordance with the conditions set forth in Notice 2005–1, Q&A–18(d), the preamble to the proposed regulations and this notice, such replacement stock options or stock appreciation rights will be treated for purposes of section 409A as if granted on the grant date of the original stock option or stock appreciation right. For a discussion of certain methods that commentators proposed to use to compensate option holders for the value of a lost discount, see section XI.H of the preamble to the proposed regulations.

(2) Paragraph .06 of § 3 of Notice 2006–79 is modified and superseded to read as follows:

.06 *Other transition issues*

Notice 2005–1, Q&A–21 provided relief with respect to certain initial deferral elections, generally providing that certain requirements would not be applicable to elections made on or before March 15, 2005. One of the conditions of the relief was that the plan be amended to comply with the requirements of section 409A in accordance with Notice 2005–1, Q&A–19. Notice 2005–1, Q&A–19 generally required that plans be amended by December 31, 2005. The March 15, 2005 deadline for initial deferral elections was not extended in the preamble to the proposed regulations; however, the plan amendment requirement generally was extended to December 31, 2006. Although the initial deferral election relief contained in Notice 2005–1, Q&A–21 only referred to the requirements of Notice 2005–1, Q&A–19, the Treasury Department and the IRS have become aware that many taxpayers interpreted the extension of the plan amendment deadlines as flowing through to the requirements of Notice 2005–1, Q&A–21. To avoid unintentional noncompliance in this area, the deadline for a plan to be amended to reflect use of the relief provided in Notice 2005–1, Q&A–21 is extended to December 31, 2008. However, taxpayers retain the burden of demonstrating satisfaction of the requirement by showing that the deferral election was made by the March 15, 2005 deadline, in accordance with the plan terms in effect on or before December 31, 2005 (other than a requirement to make a deferral election on or before March 15, 2005). See Notice 2005–1, Q&A–21.

(3) Paragraphs .05 and .07 of § 3 of Notice 2006–79 are not affected by this notice.

.02 Modification of Transition Relief Provided in the Final Regulations Preamble

The relief provided in sections XII and XIII of the final regulations preamble is modified to reflect the extension of the Notice 2006–79 transition relief through December 31, 2008, and the guidance provided in section XIV of the final regulations preamble is modified with respect to periods after December 31, 2007, as follows:

(A) *General rule.* Sections XII and XIII of the final regulations preamble are ap-

plied by substituting references to December 31, 2008 for references to December 31, 2007, and substituting references to January 1, 2009 for references to January 1, 2008. However, references to April 10, 2007 (the date of issuance of the final regulations) and October 3, 2004 (the enactment date of the statute) are not modified.

(B) *Section XII.C.* With respect to the determination of the fair market value of stock, the last sentence of the second paragraph of section XII.C of the final regulations preamble is modified to delete the words "proposed or" so as to eliminate reliance on the provisions of the proposed regulations.

(C) *Section XII.D.* With respect to programs established before April 10, 2007 where initial deferral elections have not been made by January 1, 2008, the transition relief provided in the second paragraph of section XII.D of the final regulations preamble remains unchanged (that is, no further transition relief is provided by this notice).

(D) *Section XIV.* The guidance provided in section XIV of the final regulations preamble (Calculation and Timing of Income Inclusion Amounts, Reporting and Withholding) on the application of section 409A before January 1, 2008 is extended to apply before January 1, 2009 except that paragraph A of such section is not changed.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Nothing in this notice is intended to limit the scope or applicability of the transition relief provided in Notice 2005–1, the proposed regulations or Notice 2006–79 for periods before January 1, 2008. This notice does not affect the guidance provided in Notice 2006–33, 2006–1 C.B. 754 (relating to the application of section 409A(b)), Notice 2005–94, 2005–2 C.B. 1208 (relating to reporting and wage withholding for 2005) and Notice 2006–100, 2006–51 I.R.B. 1109 (relating to reporting and wage withholding for 2006). Notwithstanding the section of the final regulations preamble entitled "Effect on Other Documents", Notice 2005–1 is obsoleted only for taxable years beginning on or after January 1, 2009, except for the following sections of Notice 2005–1, which remain effective after that date as modified by any other applicable guidance: Q&A–6 (application to arrangements covered by section 457); Q&A–7 (application to arrangements between a partnership and a partner of the partnership); and Q&A–24 through Q&A–38 (information reporting and withholding guidance).

Pursuant to this notice, Notice 2006–4, 2006–3 C.B. 307 (relating to the application of section 409A to certain outstanding stock rights), is superseded by the final regulations with respect to stock rights issued in taxable years of the service provider beginning after December 31, 2008. Notice 2006–64, 2006–29 I.R.B. 88 (relating to the acceleration of payments to comply with certain conflict of interest rules), is superseded by the final regulations effective for taxable years of the service provider beginning after December 31, 2008.

Section III of Notice 2007–78 is revoked and superseded by this notice. Pursuant to this notice, the penultimate paragraph and the first sentence of the final paragraph of § IV.A of Notice 2007–78 are modified by substituting references to December 31, 2008 for references to December 31, 2007. The guidance otherwise provided in § IV of Notice 2007–78 is not affected by this notice. Section 3 of Notice 2006–79 is modified and superseded as provided in this notice. The guidance and relief provided in the final regulations preamble is modified as provided in this notice.

The Treasury Department and the IRS anticipate issuing guidance as soon as possible with respect to the correction program and other matters discussed in § V of Notice 2007–78 and this notice does not affect that section. In addition, this notice does not affect the guidance provided in § VI of Notice 2007–78.

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are Stephen Tackney and Bill Schmidt of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury Department and IRS officials participated in its development. For further information on the provisions of this notice, contact Stephen Tackney or Bill Schmidt at (202) 927–9639 (not a toll-free number).

Proposed Changes to the Process for Obtaining the Commissioner's Consent to Change a Method of Accounting

Notice 2007–88

PURPOSE

This notice requests comments from the public regarding a proposal to change the process by which taxpayers obtain the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. The proposal described in this notice is one possible approach. The Internal Revenue Service (IRS) is interested in considering other possible approaches. Therefore, changes to the process, including any pilot program, will not become effective until the IRS considers public comments and suggestions received in response to this notice and publishes guidance announcing changes to the process.

BACKGROUND

A. *The Existing Accounting Method Change Process*

Section 446(e) of the Internal Revenue Code requires taxpayers to obtain the consent of the Commissioner before changing a method of accounting for federal income tax purposes. A change in a method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. Taxpayers request the Commissioner's consent to change a method of accounting by filing a Form 3115, *Application for Change in Accounting Method*, that describes the current and new methods of accounting, identifies items that will be treated differently under the new method of accounting, and includes a computation of any adjustment required by section 481(a).

The Commissioner has issued administrative procedures instructing taxpayers

how and when to file Form 3115, and prescribing the terms and conditions necessary to obtain consent to change an accounting method. These procedures are contained principally in Rev. Proc. 2002–9, 2002–1 C.B. 327, as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432 ("automatic consent process") and Rev. Proc. 97–27, 1997–1 C.B. 680, as modified and amplified by Rev. Proc. 2002–19, as amplified and clarified by Rev. Proc. 2002–54 ("nonautomatic consent process").

1. *The automatic consent process*

Under the existing process, the Commissioner grants eligible taxpayers automatic consent to change to certain methods of accounting, most of which are described in the Appendix to Rev. Proc. 2002–9. A taxpayer that seeks to change to one of these methods must attach Form 3115 to its timely filed (including extensions) original income tax return for the requested year of change and send a copy of the Form 3115 to the IRS national office no later than the date that the original Form 3115 is filed with the federal income tax return for the year of change. In general, a taxpayer, not under audit, complying with all the applicable provisions of Rev. Proc. 2002–9 has obtained the consent of the Commissioner to change its method of accounting and ordinarily receives both "audit protection" and "ruling protection." That is, the IRS will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change ("audit protection"). The IRS also will not require the taxpayer to change or modify the new method of accounting except in certain circumstances specifically enumerated in section 8 of Rev. Proc. 2002–9 and, if the IRS does require the taxpayer to change or modify the new method of accounting, the required change or modification to the new method of accounting generally will not be applied retroactively ("ruling protection"). In other words, the taxpayer receives protection with respect to the use of the new method of accounting in future years.

Rev. Proc. 2002–9 is the exclusive procedure for a taxpayer within the scope of Rev. Proc. 2002–9 to obtain the consent of the Commissioner before changing a method of accounting. Accordingly, a taxpayer that qualifies to make a change through the automatic consent process may not opt to make the change under the nonautomatic consent process described below. A user fee is not charged in the automatic consent process.

The IRS national office reviews Forms 3115 filed through the automatic consent process to determine whether the form is properly completed and whether the taxpayer qualifies for automatic consent. If the IRS national office reviews a Form 3115 and determines that the form is not properly completed, or if supplemental information is needed, the IRS national office notifies the taxpayer, specifies the information that is needed, and permits the taxpayer 30 days to furnish the necessary information. If the IRS national office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of Rev. Proc. 2002–9, the IRS national office notifies the taxpayer of its tentative adverse determination and offers the taxpayer a conference of right, if the taxpayer has requested such a conference. In cases where the IRS national office remains adverse after the conference of right, it notifies the taxpayer that consent to make the change in method of accounting is not granted.

2. *The nonautomatic consent process*

Changes that do not qualify for automatic consent must be requested under the nonautomatic consent process described in Rev. Proc. 97–27. A taxpayer that seeks the Commissioner's consent to change a method of accounting through the nonautomatic consent process must file Form 3115 with the IRS national office during the taxable year in which the taxpayer desires to make the proposed change. There is a user fee for a nonautomatic consent request (in general, the current fee is $2,500 per request).

In processing a request for a change in method of accounting made through the nonautomatic consent process, the IRS national office considers, among other factors, whether the requested method of accounting is legally permissible for the taxpayer, whether the requested method clearly reflects the taxpayer's income, and whether the taxpayer has appropriately computed any adjustment required by section 481(a). The processing of a taxpayer's request for an accounting method change may involve requests for supplemental information from the taxpayer, including requests for additional facts and clarification of how the taxpayer intends to apply the requested method to particular types of transactions. If supplemental information is needed, the IRS national office notifies the taxpayer and the taxpayer generally is permitted 21 days to furnish the necessary information.

If the taxpayer's requested accounting method change is approved by the IRS national office, the taxpayer receives a letter ruling granting the taxpayer consent to make the change subject to certain terms and conditions. The taxpayer also generally receives audit protection and ruling protection. In cases where the IRS national office is tentatively adverse to the taxpayer's requested change in method of accounting, the IRS national office notifies the taxpayer of its tentative adverse determination and offers the taxpayer a conference of right, if the taxpayer has requested such a conference. If the IRS national office remains adverse after the conference of right, it notifies the taxpayer that consent to make the change in method of accounting is denied.

B. *Reasons for Change*

The IRS is concerned that certain aspects of the existing accounting method change process make it a complex and inefficient means for taxpayers to obtain consent to change an accounting method. These complexities and inefficiencies often result in significant delays in the processing of accounting method change requests. The IRS believes that an efficient process that provides taxpayers with a means of obtaining timely consent to change to a proper method of accounting is crucial to ensuring that taxpayers comply with the consent requirement of section 446(e). Accordingly, the IRS is considering proposals to modify the accounting method change process. In considering any modifications to the existing process, the IRS will balance taxpayers' need for timely consent with the Commissioner's responsibility to ensure that the process comports with the purpose underlying section 446(e).

Prior to the codification of sections 446(e) and 481 in 1954, the regulations imposed a "consent" requirement on taxpayers seeking a change in accounting method, the purpose of which was to give the Commissioner the opportunity to insist on compensating adjustments to eliminate the omissions and duplications of income and deductions that can result from a change in accounting method. Today, section 481(a) provides for such adjustments, thereby diminishing the role of the consent requirement as a means for the Commissioner to mandate these adjustments. The consent requirement is recognized today as serving broader policy aims, such as promoting consistent accounting practices and easing the administrative burden on the Commissioner of detecting accounting method changes.

The IRS believes that the proposal contained in this notice fulfills the broad policy aims of section 446(e). As under the existing automatic consent and nonautomatic consent processes, the IRS intends to review all accounting method change requests, and to focus on those that raise novel or controversial accounting method change issues. The IRS expects that the proposal contained in this notice will simplify the consent process and reduce delays for most taxpayers, while preserving the ability of the IRS to effectively monitor changes of accounting methods.

PROPOSAL

The IRS is considering whether to modify the accounting method change process so that the existing "automatic consent" process and "nonautomatic consent" process are replaced with a system under which a taxpayer requests "standard consent," "specific consent" or "letter ruling consent."

A. *Standard Consent Process*

1. *In general*

The IRS anticipates that, under this proposal, the majority of accounting method change requests would be made through the standard consent process. The proposed standard consent process is expected to operate in a manner similar to the existing automatic consent process — a taxpayer that timely files Form 3115 with its tax return and complies with the procedures governing the process is granted the Commissioner's consent to change its method of accounting. A change made under the standard consent process must be made under the published terms and conditions applicable to the standard consent process. No letter ruling would be issued by the IRS, and no user fee would be charged.

All changes in method of accounting that are specifically identified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance, would be eligible for consent under the standard consent process. As is the case under the existing automatic consent process, taxpayers changing to one of these specifically identified methods of accounting would ordinarily obtain audit protection and ruling protection. The IRS anticipates that Rev. Proc. 2002–9 (or any successor), and other automatic consent guidance, would be incorporated into the administrative procedures that govern the standard consent process. Consequently, the standard consent process would be the exclusive process available to taxpayers changing to methods of accounting specifically identified in Rev. Proc. 2002–9 (or any successor) and other automatic consent guidance.

This proposal contemplates that the standard consent process would be available even for changes that are not identified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance. That is, except for changes required to be made under the proposed specific consent process (described below), a taxpayer that timely files Form 3115 with its tax return and complies with the procedures governing the standard consent process would have the Commissioner's consent to change to any permissible method of accounting for the requested year of change, including changes to methods of accounting not specifically identified in Rev. Proc. 2002–9 (or any successor) or other automatic consent guidance. However, unlike the consent applicable to method changes specifically identified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance, a taxpayer's change of its method of accounting to a method other than a method specifically identified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance, would receive only audit protection for years prior to the requested year of change and would not receive ruling protection.

Although the proposal contemplates that taxpayers would file Form 3115 with their returns for the requested year of change, the IRS is considering an alternative approach under which taxpayers would be required to file Form 3115 for changes to methods of accounting not specifically identified in Rev. Proc. 2002–9 (or any successor) or other automatic guidance, by the last day of the ninth month of the requested taxable year of change. Requiring Form 3115 to be filed during the requested taxable year of change, rather than with the tax return for the requested taxable year of change, would provide the IRS with time to consider the request before the taxpayer files its return for the requested taxable year of change. The IRS requests comments on this alternative approach.

The IRS expects that the standard consent process would give taxpayers who seek consent under section 446(e) without ruling protection the opportunity to obtain this consent in a timely and efficient manner. The taxpayer's filing of Form 3115 would give the IRS adequate notice of the change in accounting method. Further, the lack of ruling protection for changes that are not specified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance, puts the taxpayer in no worse a position with regard to the new method of accounting as the taxpayer is in with regard to other items of income or deduction reported on the return. That is, the taxpayer's use of the new method of accounting is an issue that may be considered upon examination.

2. *IRS review of Forms 3115*

Under the proposal, the IRS would screen accounting method change requests for completeness and for compliance with the procedures governing the standard consent process. Requests that are not substantially complete would be denied consent and the taxpayer would be notified that consent is not granted. In contrast to the procedures contained in section 10.02 of Rev. Proc. 2002–9, under the proposal, the IRS does not intend to permit taxpayers to perfect requests that are not substantially complete prior to denying consent. As a consequence, a taxpayer who submits a form that is not substantially complete would not receive consent

to change its method of accounting for the proposed year of change and, thus, would not receive ruling protection or audit protection. The IRS plans to issue guidelines and examples of what constitutes a substantially complete Form 3115. For example, a Form 3115 must include sufficient information about the current and new methods of accounting to permit the IRS to understand how the methods work, and must identify legal authority (including any contrary authority) governing the new method of accounting. However, minor omissions or errors on Form 3115 would not result in the denial of consent.

In addition to screening accounting method change requests for completeness, the IRS would review Forms 3115 filed under the standard consent process to determine whether the new accounting method is permissible. In cases where the IRS agrees that the new method is permissible, ordinarily no further action would be taken and the taxpayer would not be advised that the review has taken place. In cases where the IRS questions the propriety of the new method, the IRS may correspond with the taxpayer to resolve the matter. In some cases, resolution may require the taxpayer to provide additional information about the change. If the IRS tentatively determines that the new method of accounting is impermissible, the IRS would notify the taxpayer of the tentative adverse determination and will ordinarily offer the taxpayer a conference. In cases where the IRS remains adverse after the conference, it would notify the taxpayer that consent to make the change in method of accounting is not granted.

Under the existing accounting method change process, the IRS provides audit protection for changes in method of accounting only if the request for change is granted. The IRS is considering whether it would be appropriate to provide audit protection even in cases where consent is not granted. Providing audit protection in such cases may encourage taxpayers to seek consent to change from improper methods of accounting.

B. *Specific Consent Process*

The specific consent process is proposed to be available for only two categories of accounting method changes: (1) accounting method changes specifically identified in published guidance as required to be made under the specific consent process, and (2) changes that otherwise qualify under the standard consent process, but for which the taxpayer seeks different terms and conditions or a waiver of certain scope limitations that apply to the standard consent process. Each of these categories is discussed in further detail below. The IRS expects that under this proposal a user fee would apply to a change requiring specific consent.

1. *Changes identified in published guidance*

Under the proposal, the IRS would publish guidance in the Internal Revenue Bulletin that lists specific accounting method changes that must be made using the specific consent process. The specific accounting method changes listed in this published guidance would include the types of changes that the IRS wants to review in more depth and prior to the taxpayer implementing the accounting method on its tax return. The IRS would update the proposed published list as necessary to add or remove specific accounting method changes that are required to be made under the specific consent process. The IRS expects that, in general, the process for requesting specific consent would be similar to the existing advance consent process described in Rev. Proc. 97–27. That is, a taxpayer files a Form 3115 that is substantially complete (as discussed above in the description of the standard consent process) and awaits a ruling from the IRS granting consent to the change. To give the IRS adequate time to consider the request prior to the due date of the taxpayer's tax return for the requested taxable year of change, the IRS expects to require taxpayers to file Form 3115 by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed request for the succeeding taxable year.

If a taxpayer's consent request is granted, audit protection would apply and ruling protection would usually apply. However, the IRS, in its discretion, may decline to grant ruling protection in a particular case.

2. *Changes seeking modified terms and conditions or a waiver of certain scope limitations*

The specific consent process would also apply to any change that otherwise qualifies for the standard consent process (including a change specifically identified in Rev. Proc. 2002–9, or any successor, or other automatic consent guidance), but for the fact that the taxpayer seeks a term and condition different from those that apply to standard consent requests, or seeks a waiver of certain scope limitations that apply to standard consent requests. For example, a taxpayer that filed a Form 3115 under the standard consent process and seeks to make a subsequent change to the same item within five years would be required to request consent under this specific consent process to make the subsequent change. As provided in section 8.02 of Rev. Proc. 97–27, the IRS may determine that, based on the unique facts of a particular case and in the interest of sound tax administration, terms and conditions that differ from those that ordinarily apply are more appropriate for a particular accounting method change. It is not intended that under this proposal the IRS would change its policy concerning the circumstances in which it will approve a request for modified terms and conditions. Taxpayers should be aware that it is only in rare situations that the IRS agrees to a taxpayer's request for terms and conditions different from those prescribed in published guidance.

To give the IRS adequate time to consider the request prior to the due date of the taxpayer's tax return for the requested taxable year of change, the IRS expects to require taxpayers to file Form 3115 by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed request for the succeeding taxable year.

Under the proposal, in cases where the IRS agrees to the modified term and condition or the waiver of certain scope limitations, any consent would be granted under the standard consent process, generally with audit protection and without ruling protection. That is, no ruling letter would be issued; the IRS would simply issue a waiver that permits the taxpayer to utilize the standard consent process to make the change with the modified term and condition or with a waiver of the scope limitation. In appropriate cases, the IRS would limit audit protection where the taxpayer previously received audit protection for the same item under the standard consent process.

C. *Letter Ruling Consent Process*

The IRS recognizes that some taxpayers who seek to change an accounting method may want the certainty of a letter ruling issued by the IRS national office concerning the propriety of a requested method of accounting. Under the proposal, a taxpayer that seeks a change in accounting method other than a change that is specifically identified in Rev. Proc. 2002–9 (or any successor), or other automatic consent guidance, may request a letter ruling under Rev. Proc. 2007–1, 2007–1 I.R.B. 1, (or its successor). The IRS would apply Rev. Proc. 2007–1 (or its successor) and Rev. Proc. 2007–3, 2007–1 I.R.B. 108, (or its successor) in determining whether to rule on a request filed under the letter ruling consent process.

The IRS is concerned that requests for accounting method changes made under the existing advance consent process often are not as well developed as requests for letter rulings generally. Under this proposal, a taxpayer utilizing the letter ruling consent process must submit a fully developed request, and that request would be subject to the same standard of factual and legal development as a request for a letter ruling generally. Under this proposal, a letter ruling request would include, among other information, a complete statement of facts, copies of documents pertinent to the transaction, statements of supporting and contrary authorities, examples of the application of the new method to the taxpayer's transaction and a completed Form 3115 as an attachment to the letter ruling request. As provided in Rev. Proc. 2007–1, taxpayers must provide any additional information requested by the IRS and, if a taxpayer does not submit the information within 21 calendar days from the date of the request, the letter ruling request would be closed and the taxpayer would be notified in writing.

Requests made under this letter ruling consent process would be subject to the generally applicable user fee imposed on letter ruling requests, and not the user fee currently imposed in the existing advance consent process. Further, the IRS intends to require taxpayers to submit letter ruling consent requests by the last day of the ninth month of the requested taxable year of change, without the possibility of relief for late requests under section 301.9100 of the Regulations on Procedure and Administration. However, the IRS intends to consider an otherwise qualified letter ruling request filed after the last day of the ninth month of a taxable year and before the beginning of the succeeding taxable year a timely filed letter ruling request for the succeeding taxable year.

If the IRS national office rules favorably on the letter ruling request, it also would grant the taxpayer consent under section 446(e) to change its method of accounting for the item that is the subject of the letter ruling request. Audit protection and ruling protection would apply.

D. *Pilot Program*

The IRS intends to implement any changes to the accounting method change process on a pilot basis before making permanent changes to the process. The IRS expects to open the pilot program to all taxpayers making an accounting method change within a specified pilot period. During the pilot period, the IRS will continue to evaluate the process. The IRS emphasizes that this notice does not establish a pilot program. The IRS will consider public comments received in response to this notice before establishing a pilot program in separate guidance. In the meantime, taxpayers must continue to follow the existing procedures (*e.g.*, Rev. Proc. 97–27 and Rev. Proc. 2002–9) for obtaining consent to change an accounting method.

REQUEST FOR COMMENTS

The proposal contained in this notice is one way, but not the only way, that the accounting method change process could be modified to improve efficiencies and reduce delays both for taxpayers and the IRS. The IRS requests public comments on this proposal and any other suggestions for modifying and improving the accounting method change process. Any modification to the accounting method change process will not become effective until the IRS considers any public comments received and publishes additional guidance announcing changes to the process.

Written submissions in response to this notice should be submitted no later than January 18, 2008, to Internal Revenue Service, CC:PA:LPD:RU (Notice 2007–88), room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:RU (Notice 2007–88), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, submissions may be submitted via the Internet at *Notice.Comments@irscounsel.treas.gov* in which case "Notice 2007–88" should be in the subject line. All submissions will be available for public inspection and copying in their entirety. Therefore, submissions received by the IRS should not include taxpayer-specific information of a confidential nature. Submissions should include the name and telephone number of a person to contact.

DRAFTING INFORMATION

The principal authors of this notice are Andrew J. Keyso and Brenda D. Wilson of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Keyso or Ms. Wilson at (202) 622–4800 (not a toll-free call).

Reporting and Wage Withholding Under Internal Revenue Code § 409A

Notice 2007–89

I. PURPOSE

This notice provides guidance to employers and payers on their reporting and wage withholding requirements for calendar year 2007 with respect to amounts includible in gross income under § 409A of the Internal Revenue Code. This notice also provides guidance to employers and payers on their reporting requirements with respect to all deferrals of compensation under § 409A of the Internal Revenue Code for 2007. This notice does not affect the application of § 3121(v)(2) or an employer's reporting obligations under § 31.3121(v)(2)–1 of the Employment Tax Regulations. In addition, this notice provides guidance to service providers on their income tax reporting and tax payment requirements with respect to amounts includible in gross income under § 409A for 2007. Generally, these requirements for 2007 reflect an extension to 2007 tax years of the guidance provided in Notice 2006–100 applicable to 2005 and 2006 tax years.

II. BACKGROUND

A. The American Jobs Creation Act of 2004

Section 885 of the American Jobs Creation Act of 2004, Pub. Law No. 108–357, 118 Stat. 1418 (the Act), added § 409A, which provides, *inter alia*, that all amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are met. Section 885(b) of the Act amended the Code to impose the following reporting and wage withholding requirements with respect to deferrals of compensation within the meaning of § 409A.

- The Act amended §§ 6041 and 6051 to require that an employer or payer report all deferrals for the year under a nonqualified deferred compensation plan on a Form W–2 *(Wage and Tax Statement)* or a Form 1099–MISC (*Miscellaneous Income*), regardless of whether such deferred compensation is includible in gross income under § 409A(a).

- The Act amended § 3401(a) to provide that the term "wages" includes any amount includible in the gross income of an employee under § 409A.

- The Act amended § 6041 to require that a payer report amounts includible in gross income under § 409A that are not treated as wages under § 3401(a).

B. Notice 2005–1

On December 20, 2004, the IRS issued Notice 2005–1, 2005–1 C.B. 274, which provides guidance with respect to the application of § 409A. Additionally, in accordance with the amendments made by § 885(b) of the Act, Notice 2005–1 provides the following with respect to reporting and wage withholding requirements for deferred amounts:

- An employer reports to an employee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 12 of Form W–2 using code Y. See Q&A–29.

- An employer reports amounts includible in gross income under § 409A and in wages under § 3401(a) in box 1 of Form W–2 as wages paid to the employee during the year and subject to income tax withholding. An employer also reports such amounts in box 12 of Form W–2 using code Z. See Q&A–33.

- A payer reports to a nonemployee the total amount of deferrals for the year under a nonqualified deferred compensation plan in box 15a of Form 1099–MISC. See Q&A–30.

- A payer reports amounts includible in gross income under § 409A and not treated as wages under § 3401(a) as nonemployee compensation in box 7 of Form 1099–MISC. A payer also reports such amounts in box 15b of Form 1099–MISC. See Q&A–35.

C. Final Regulations

On April 10, 2007, the IRS issued final regulations (T.D. 9321, 2007–14 I.R.B. 865) regarding the application of § 409A, applicable for taxable years beginning on or after January 1, 2008. See 72 Fed. Reg. 19234 (April 17, 2007). The regulations generally incorporate and expand on the guidance provided in Notice 2005–1. Under Notice 2007–86, 2007–46 I.R.B. 990 (November 13, 2007), taxpayers generally are not required to comply with the final regulations until January 1, 2009, but taxpayers may rely on the final regulations for periods before January 1, 2009. The final regulations generally supersede Notice 2005–1 for periods beginning after 2008. However, the regulations do not address reporting and withholding requirements, and accordingly do not supersede Notice 2005–1, Q&A–24 through Q&A–38, which address those issues. See Preamble to the Final Regulations, Effect on Other Documents, 72 Fed. Reg. 19275.

D. Notice 2006–100

On November 30, 2006, the IRS issued Notice 2006–100, 2006–51 I.R.B. 1109, which provided guidance to employers and payers on their reporting and withholding obligations with respect to deferrals of compensation and amounts includible in gross income under § 409A during calendar years 2005 and 2006. The notice permanently waived employers' and payers' reporting requirements under §§ 6041 and 6051 for calendar years 2005 and 2006 with respect to annual deferrals of compensation within the meaning of § 409A (Form W–2, Box 12, Code Y and Form 1099, Box 15a). The notice also provided guidance regarding the calculation of amounts includible in income under § 409A, and the application of the employer and payer reporting and withholding requirements for such amounts under § 409A (Form W–2, Box 12, Code Z and Form 1099, Box 15b).

III. INTERIM EMPLOYER AND PAYER REPORTING AND WAGE WITHHOLDING PROVISIONS

This section provides guidance on employers' and payers' reporting and wage withholding requirements for calendar year 2007.

A. 2007 Annual Deferrals

1. Amounts Reportable on Form W–2

For calendar year 2007, an employer is not required to report amounts deferred during the year under a nonqualified deferred compensation plan subject to § 409A in box 12 of Form W–2 using code Y.

2. Amounts Reportable on Form 1099–MISC

For calendar year 2007, a payer is not required to report amounts deferred during the year under a nonqualified deferred compensation plan subject to § 409A in box 15a of Form 1099–MISC.

B. 2007 Reporting and Withholding on Amounts Includible in Gross Income under § 409A

Section 3401(a) provides that for income tax withholding purposes the term "wages" includes any amount includible in gross income of an employee under § 409A, and payment of such amount is treated as having been made in the taxable year in which the amount is includible in gross income. Thus, for calendar year 2007, an employer must treat amounts includible in gross income under § 409A as wages for income tax withholding purposes. An employer is required to report such amounts as wages paid on line 2 of Form 941, *Employer's QUARTERLY Federal Tax Return*, and in box 1 of Form W–2. An employer must also report such amounts as § 409A income in box 12 of Form W–2 using code Z. Amounts includible in gross income under section § 409A are supplemental wages for purposes of determining the amount of income tax required to be deducted and withheld under § 3402(a), regardless of whether the employer has paid the employee any regular wages during the calendar year of the payment. *See* Publication 15 for the withholding rules with respect to supplemental wages. The amount required to be withheld is not increased on account of the additional income taxes imposed under § 409A(a)(1)(B). Employees should thus be aware that estimated tax payments may be required to avoid penalties under § 6654.

For nonemployees, § 6041(g)(2) requires a payer to report to a nonemployee any amount that is includible in gross income under § 409A that is not treated as wages under § 3401(a). Thus, for calendar year 2007, a payer must report amounts includible in gross income under § 409A and not treated as wages under § 3401(a) as nonemployee compensation in box 7 of Form 1099–MISC. A payer must also report such amounts as § 409A income in box 15b of Form 1099–MISC.

1. Calculation of Amounts Includible in Income under § 409A(a) — In General

Section 409A(a)(1)(A)(i) provides that if at any time during a taxable year a nonqualified deferred compensation plan fails to meet the requirements of § 409A(a)(2), (3) or (4), all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. Accordingly, for purposes of this notice, the amount includible in gross income under § 409A(a) and required to be reported by the employer or payer equals the portion of the total amount deferred under the plan that, as of December 31, 2007, is not subject to a substantial risk of forfeiture as defined in Notice 2005–1, Q&A–6, or the final regulations, and has not been included in income in a previous year, plus any amounts of deferred compensation paid or made available to the service provider under the plan during the calendar year 2007. For purposes of this paragraph, an employer or payer may treat an amount as previously included in income if properly reported by the employer or payer on a 2005 or 2006 Form W–2, Form 1099–MISC, or Form W–2c or corrected Form 1099–MISC. Thus, amounts properly reported on a 2005 or 2006 Form W–2 or Form 1099–MISC, or Form W–2c or corrected Form 1099–MISC should not be reported again on a 2007 Form W–2 or Form 1099–MISC. For the definition of a plan, including the plan aggregation rules, see Notice 2005–1, Q&A–9, and § 1.409A–1(c).

Amounts includible in gross income under § 409A(a) include only amounts deferred that are subject to § 409A. Accordingly, for purposes of this section III.B.1., references to amounts deferred under a plan, including references to account balances, refer solely to amounts deferred that are subject to § 409A and not, for example, to amounts deferred that were earned and vested prior to January 1, 2005 and that are not otherwise subject to § 409A due to the application of the effective date provisions. For rules regarding the application of the effective date provisions of § 409A to nonqualified deferred compensation plans, see § 1.409A–6.

The provisions of this notice addressing the calculation of the amounts includible in income are intended as interim guidance only. The Treasury Department and the IRS are currently formulating general guidance with respect to the calculation of the amounts includible in income, as well as other related issues. For information regarding the submission of comments on these topics, see section V. of this notice.

2. Wage Payment Date of Amounts Includible in Income under § 409A(a)

Amounts includible in gross income under § 409A(a) in 2007 that are either actually or constructively received (disregarding the application of § 409A) by an employee during the calendar year 2007, are considered a payment of wages by the employer when received by the employee for purposes of withholding, depositing, and reporting the income tax at source on wages under § 3401(a).

Amounts includible in gross income under § 409A(a) in 2007 that are neither actually nor constructively received (disregarding the application of § 409A) by the employee during the calendar year 2007, are treated as a payment of wages on December 31, 2007 for purposes of withholding, depositing, and reporting the income tax at source on wages under § 3401(a). If as of December 31, 2007 the employer does not withhold income tax from the employee on such wages, or withholds less than the amount of income taxes required to be withheld under § 3402 from the employee, the employee will receive credit under § 31 for 2007 if the employer follows one of two possible options. Under the first option, notwithstanding § 31.6205–1(c)(4), the employer withholds or recovers from the employee the amount of the undercollection after

December 31, 2007 and before February 1, 2008, and reports as wages for the quarter ending December 31, 2007 such amounts that were neither actually nor constructively received but are includible in income under § 409A on Form 941 for that quarter and in box 1 of the employee's Form W–2 for 2007. Under the second option, the employer pays the income tax withholding liability on behalf of the employee (without deduction from the employee's wages or other reimbursement by the employee), and reports the gross amount of wages and the income tax withholding liability for the quarter ending December 31, 2007 as including such amounts that were neither actually nor constructively received but are includible in income under § 409A, as well as the Federal Insurance Contributions Act, Federal Unemployment Tax Act, and income tax withholding wages resulting from paying the income tax on the employee's behalf, on Form 941 and Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, and in box 1 of the employee's Form W–2 for 2007. See Rev. Rul. 58–113, 1958–1 C.B. 362 and Rev. Rul. 86–14, 1986–1 C.B. 304, for methods of computing gross wages when paying employment taxes on behalf of an employee. In addition, for purposes of the deposit requirements associated with such wages, if the income tax withholding liability with respect to such wages is paid to the IRS by the due date of the Form 941 for the quarter ending December 31, 2007 on which the wages are reported, then the amount of income tax withholding liability will be considered to have been deposited in accordance with the rules of § 31.6302–1(c). Thus, penalties for failure to deposit taxes under § 6656 will not be imposed with respect to such amount.

3. 2007 Amounts Includible in Income under § 409A(a)

The following sections provide guidance for calculating the total amount deferred under the plan as of December 31, 2007 for purposes of determining the amount required to be included in gross income under § 409A(a) in accordance with the rules described in section III.B.1. of this notice.

a. Account Balance Plans

For a plan that is an account balance plan as defined in § 1.409A–1(c)(2)(i)(A) or (B), the amount deferred as of December 31, 2007 equals the amount that would be treated as an amount deferred under § 31.3121(v)(2)–1(c)(1) on December 31, 2007 if the entire account balance under such plan (including all principal amounts, adjusted for income, gain or loss credited to the service provider's account) as of December 31, 2007 were treated as a principal amount credited to the service provider's account on December 31, 2007. These same calculation rules apply for purposes of determining the amount reported on Form 1099–MISC for calendar year 2007 with respect to a nonemployee participating in an account balance plan. For purposes of this section, a plan described in § 1.409A–1(c)(2)(i)(A) (elective account balance plan) is not aggregated with a plan described in § 1.409A–1(c)(2)(i)(B) (nonelective account balance plan).

b. Nonaccount Balance Plans — Amounts that are Reasonably Ascertainable

For a plan that is a nonaccount balance plan as defined in § 1.409A–1(c)(2)(i)(C), where the amount deferred is reasonably ascertainable within the meaning of § 31.3121(v)(2)–1(e)(4), the amount deferred as of December 31, 2007 equals the present value of all future payments to which the service provider has obtained a legally binding right as of December 31, 2007, calculated in accordance with § 31.3121(v)(2)–1(c)(2) as if the service provider had obtained all of such rights on December 31, 2007. Section 31.3121(v)(2)–1(e)(4)(i)(B) provides that an amount deferred is considered reasonably ascertainable on the first date on which the amount, form, and commencement date of the benefit payments attributable to the amount deferred are known, and the only actuarial or other assumptions regarding future events or circumstances needed to determine the amount deferred are interest and mortality. An amount does not fail to be reasonably ascertainable if alternative forms or commencement dates are available that provide an actuarially equivalent benefit to the normal benefit commencing at the normal commencement date. In addition, an amount deferred does not fail to be reasonably ascertainable on a date merely because the exact amount of the benefit payable cannot readily be calculated on that date or merely because the exact amount of the benefit payable depends on future changes in the cost of living. If the exact amount of the benefit payable depends on future changes in the cost of living, the amount deferred must be determined using a reasonable assumption as to the future changes in the cost of living. These same rules apply for purposes of determining the amount reported on Form 1099–MISC for calendar year 2007 with respect to a nonemployee participating in a nonaccount balance plan.

c. Amounts Deferred Under Stock Rights Covered by § 409A

For a plan that provides stock rights as defined in § 1.409A–1(c)(2)(i)(H), the amount deferred as of December 31, 2007 equals the amount that the service provider would be required to include in income if the stock rights were immediately exercisable and exercised on December 31, 2007. In general, this will mean with respect to a stock right outstanding as of December 31, 2007, the amount deferred as of December 31, 2007 equals the fair market value of the underlying stock less the sum of the exercise price and any amount paid by the service provider for the stock right.

d. Other Deferred Amounts

For all deferred amounts not addressed in section III.B.2.a., b., or c. of this notice, the amount deferred as of December 31, 2007 must be determined under a reasonable, good faith application of a reasonable, good faith method. For this purpose, a reasonable, good faith application of a reasonable, good faith method generally must reflect reasonable, good faith assumptions with respect to any contingencies as to the timing or amount of any payment. Generally, the use of an assumption with respect to a contingency that results in the amount deferred being the lowest potential value of the future payment will be presumed not to be a reasonable, good faith assumption unless clear and convincing evidence demonstrates that the assumption is reasonable. For example, where a payment may be made in more than one form,

the assumption that the payment will be made in the least valuable form will be presumed not to be a reasonable, good faith assumption unless clear and convincing evidence demonstrates otherwise. The assumptions concerning time and form of payment set out in § 1.409A–6(a)(3)(i) (relating to calculation of the grandfathered benefit in a nonaccount balance plan) will constitute reasonable, good faith assumptions for this purpose. If a portion of a deferred amount can be calculated under section III.B.2.a., b., or c. of this notice, a reasonable, good faith method of calculation will in fact be a combination of two methods. The method applicable under section III.B.2.a., b., or c. of this notice must be applied to the portion, and the balance of the deferred amount must be determined under a reasonable good faith method.

4. Amounts Includible in Income under § 409A(b)

Section 409A(b)(1) provides generally that in the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying deferred compensation under a nonqualified deferred compensation plan, such assets shall be treated as property transferred in connection with the performance of services for purposes of § 83 whether or not such assets are available to satisfy claims of general creditors at the time set aside if such assets (or such trust or other arrangement) are located outside of the United States, or at the time transferred if such assets (or such trust or other arrangement) are subsequently transferred outside of the United States.

Section 409A(b)(2) provides that in the case of compensation deferred under a nonqualified deferred compensation plan, there is a transfer of property within the meaning of § 83 with respect to such compensation as of the earlier of the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or the date on which assets are so restricted, whether or not such assets are available to satisfy claims of general creditors.

Section 409A(b)(3) provides that if, during a restricted period with respect to a single-employer defined benefit pension plan, assets are set aside or reserved in, or transferred to, a trust or other arrangement for purposes of paying deferred compensation for an applicable covered employee under a nonqualified deferred compensation plan of the plan sponsor or a member of its controlled group, or a nonqualified deferred compensation plan of the plan sponsor or a member of its controlled group provides that assets will become restricted to the provision of benefits, or assets are so restricted, in connection with such restricted period (or similar financial measure determined by the Secretary), the assets are treated as a transfer of property for purposes of § 83 whether or not such assets are available to satisfy claims of general creditors.

Section 409A(b)(4) provides that for each taxable year that assets treated as transferred under § 409A(b) remain set aside in a trust or other arrangement subject to § 409A(b)(1) or (2), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

Notice 2006–33, 2006–1 C.B. 754, April 10, 2006, provides transition guidance related to the application of § 409A(b) to certain arrangements outstanding as of March 21, 2006. Under that relief, amounts transferred to trusts under the arrangement on or before March 21, 2006 that triggered the income inclusion and additional taxes under § 409A(b), or arrangements that otherwise triggered the income inclusion and additional taxes under § 409A(b) on or before March 21, 2006, generally are treated as not having triggered the inclusion or additional tax provisions of § 409A(b), provided that the arrangements become compliant with § 409A(b) by January 1, 2008. Section VI of Notice 2007–78, 2007–41 I.R.B. 780, and Notice 2007–86 provide that such relief is not extended beyond December 31, 2007 and nothing in this notice is intended to modify or extend that relief.

However, where amounts have been transferred to a trust under an arrangement that triggers the income inclusion and additional taxes under § 409A(b), or the arrangement otherwise triggers the income inclusion and additional taxes under § 409A(b), and the transfer is not eligible for the relief in Notice 2006–33 (for example because the transfer occurred after March 21, 2006 or the arrangement is not made compliant with § 409A(b) by January 1, 2008), employers and payers must make a reasonable, good faith application of a reasonable, good faith method to determine the amount includible in income for purposes of reporting. In addition, employers must treat the amount as wages for purposes of § 3401. Amounts includible in income under § 409A(b) that are not eligible for the relief in Notice 2006–33 are treated as wages paid on the date the deemed transfer of property under § 83 described in § 409A(b) would be required to be included in income under the rules of § 83, for purposes of withholding, depositing and reporting the income tax at source on wages under § 3401(a). For amounts includible in income under § 409A(b) that were eligible for the relief in Notice 2006–33 ("grace period assets") but are includible in income under § 409A(b) because the arrangement is not made compliant with § 409A(b) on or before December 31, 2007, Notice 2007–78 provides that the date of the deemed transfer of property is January 1, 2008.

C. Protection from Future Additional Reporting or Withholding for 2007

An employer or payer who complies with the rules of this notice regarding computing amounts includible in gross income under § 409A and withholding and reporting for calendar year 2007 will not be liable for additional income tax withholding or penalties, or be required to file a subsequent corrected information return or furnish a corrected payee statement, as a result of future published guidance with respect to the computation of amounts includible in gross income under § 409A. If it is subsequently determined that the employer did not apply the rules of this notice in determining amounts includible in gross income under § 409A and in wages under § 3401(a) for calendar year 2007, any recalculation of these amounts will result in additional liability for income tax withholding under § 3403 for these years, plus any applicable penalties. In addition, an employer or payer who does not apply the rules of this notice in determining amounts includible in gross income under § 409A and in wages under § 3401(a) for calendar year 2007 will be required to file an

original or a corrected information return and furnish an original or a corrected payee statement. For purposes of determining any amount includible in income under § 409A in a subsequent year, an amount will not be treated as previously included in income unless the amount has been reported appropriately on an information return and payee statement, or has been included in income by the service provider in a previous year.

IV. SERVICE PROVIDER REQUIREMENTS WITH RESPECT TO AMOUNTS INCLUDIBLE IN GROSS INCOME UNDER § 409A

This section provides guidance on service providers' income tax reporting and tax payment requirements for calendar year 2007 with respect to deferrals of compensation that are includible in gross income under § 409A.

A. Amounts Required to be Included in Income

A service provider must report as income and pay any taxes due relating to amounts includible in gross income under § 409A for calendar year 2007. For purposes of determining the amount required to be included in income under § 409A, the same standards apply to a service provider as apply to an employer or payer when calculating the amount required to be reported as income, provided that an amount is treated as previously included in income only if the amount has been included in the service provider's income in a previous taxable year (regardless of whether reported on a Form W–2 or 1099–MISC). Accordingly, an employee or other service provider must calculate the amounts required to be included in gross income under the same methods and standards as set forth in section III. Whether a service provider has complied with the requirements of this notice is determined independently of whether the employer or payer has complied with the requirements of this notice. Thus, if the service provider includes in income the same amount reported by the employer or payer, the service provider has not necessarily complied with the terms of this notice.

If the service provider does not report and pay taxes due with respect to amounts includible in gross income under § 409A for calendar year 2007 in accordance with the guidance contained in this notice, the IRS may assert additional income taxes and penalties under §§ 6651(a)(1) and (2), 6654, and 6662 if it is determined that the amount of taxes reported and paid for calendar year 2007 was underreported or underpaid. Interest imposed under Chapter 67 of the Code will apply to any underpayments of tax resulting from a service provider's failure to include amounts includible in gross income under § 409A for calendar year 2007. For purposes of determining the amount includible in income under § 409A in a subsequent year, the service provider may treat an amount as previously included in income only if the service provider has actually and properly included the amount in gross income in a previous year.

B. Calculation of Additional Tax under § 409A(a)(1)(B)(i)(I)

Section 409A(a)(1)(B)(i)(I) provides that if compensation is required to be included in gross income under § 409A(a)(1)(A), the tax imposed on such income is increased by the sum of two additional taxes equal to the amount of interest determined under § 409A(a)(1)(B)(ii) plus an amount equal to 20% of the compensation which is required to be included in gross income. Section 409A(a)(1)(B)(ii) provides that the amount of interest is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

Section 885(d)(1) of the Act provides that § 409A generally applies to amounts deferred after December 31, 2004. Section 885(d)(2)(B) of the Act provides that amounts deferred in taxable years beginning before January 1, 2005, shall be treated as amounts deferred in a taxable year beginning on or after such date if the plan under which the deferral is made is materially modified after October 3, 2004. Accordingly, for purposes of the calculation of the additional tax under § 409A(a)(1)(B)(ii), taxpayers may treat amounts deferred under a plan that were originally deferred on or before January 1, 2005 but became subject to § 409A due to the material modification of the plan after October 3, 2004 as deferred on January 1, 2005.

V. REQUEST FOR COMMENTS

The provisions of this notice are intended as interim guidance only. The Treasury Department and the IRS are currently formulating general guidance with respect to the income inclusion requirements, the additional taxes, and the reporting and withholding requirements of § 409A. The Treasury Department and the IRS request comments on all aspects of these requirements, including but not limited to the topics addressed in this notice.

Comments must be submitted by February 13, 2008. All materials submitted will be available for public inspection and copying.

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2007–89), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2007–89), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2007–89) in the subject line.

VI. EFFECT ON OTHER DOCUMENTS

Notice 2005–1 is modified. Notice 2006–100 is not affected by this notice.

VII. EFFECTIVE DATE

This notice is effective with respect to employers' and payers' reporting and wage withholding requirements and with respect to service providers' filing requirements and tax payment obligations relating to amounts includible in gross income under § 409A for calendar year 2007.

VIII. DRAFTING INFORMATION

The principal author of this notice is Don M. Parkinson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury and IRS officials participated in its development. For further information on the provisions of this notice addressing the calculation of the amount includible in income under § 409A, contact Stephen Tackney at (202) 927–9639; for further information on other provisions of this notice, including the reporting and withholding provisions contained in this notice, contact Mr. Parkinson at (202) 622–6040 (not toll-free numbers).

Security Under Section 6166 Elections

Notice 2007–90

PURPOSE

The purpose of this notice is to alert taxpayers, tax practitioners, executors and other persons who represent estates, that, in light of a recent Tax Court decision, the Internal Revenue Service is changing its policy and now will determine on a case-by-case basis whether security will be required when a qualifying estate elects under Internal Revenue Code section 6166 to pay all or a part of the estate tax in installments. This notice invites comments from the public regarding the relevant factors and appropriate standards for determining whether security is deemed to be necessary (and thus will be required) to protect the government's interest in obtaining full payment of the estate tax and interest thereon when that liability is deferred under section 6166.

BACKGROUND

Under section 6166, an estate that meets all of the requirements of the statute may elect to pay the estate tax attributable to the decedent's interest in a closely held business in up to 10 equal, annual installments. The first of those annual payments must be made by the 5th anniversary of the due date (determined without regard to any extension) of the estate tax liability that is not deferred under section 6166. An estate qualifies for a section 6166 election if the value of the decedent's interest in the closely held business exceeds 35 percent of the adjusted gross estate, the decedent was a United States citizen or resident at the time of his or her death, and the estate made the election by attaching a full and complete notice of election with a timely filed federal estate tax return. I.R.C. § 6166(a) and (d). If the estate qualifies for the election, the estate pays a reduced rate of interest on the portion of estate tax deferred under section 6166; that interest is payable annually during the entire deferral period, and in most instances, interest only is paid during the first four years of the deferral period. I.R.C. §§ 6166(f) and 6601(j). The deferred tax is payable in no more than ten equal annual installments, beginning on a date that is not more than five years after the due date of the Federal estate tax return, which is generally nine months from the date of death. I.R.C. §§ 6166(a)(1) and (3).

Under section 6324(a), a general federal estate tax lien arises upon the decedent's date of death and attaches for ten years to all assets of the gross estate (except those used to pay certain expenses). This general federal estate tax lien may not be extended beyond the ten-year period following the date of death. As a result, when an estate qualifies and elects under section 6166 to pay estate tax over a period of up to 14 years, the government's interest in the deferred estate tax is secured by the general federal estate tax lien for only the first nine years and three months of the installment payment period. (Although the lien runs from the date of death, the installment payment period generally runs from the normal payment due date, nine months after the date of death, thus reducing the time the general lien protects the government to nine years and three months). During the final four years and nine months of the 14-year installment payment period, the government's interest is no longer secured by the general estate tax lien. In most cases, approximately one-half of the total deferred estate tax still remains to be paid during that final, unsecured portion of the deferral period.

Sections 6166(k)(1) and 6165, however, permit the IRS to require a surety bond (not exceeding double the amount with respect to which the extension is granted) from an estate to ensure payment of the deferred estate tax to be paid in installments under section 6166. In lieu of the requirement to post a surety bond, the executor may elect to grant the IRS a special extended estate tax lien (in the amount of the deferred amount plus any interest, additional amount, addition to tax, assessable penalty, and costs attributable to the deferred amount) to secure the government's interest. I.R.C. §§ 6166(k)(2) and 6324A. This special lien does not expire until the earlier of the date the estate tax is paid in full or the tax becomes uncollectible. I.R.C. §§ 6324A(d)(2), 6502, and 6503(d).

In March 2000, the Treasury Inspector General for Tax Administration recommended, in report 2000–30–059 "The Internal Revenue Service Can Improve the Estate Tax Collection Process," that the IRS protect the government's interest in estate tax deferred under section 6166. In 2002 in response to that report, the IRS implemented a policy requiring a surety bond, or in the alternative, a section 6324A special lien, as a prerequisite to making the section 6166 election. On April 12, 2007, in *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007), the Tax Court held that the IRS had abused its discretion by requiring that all estates electing to pay the estate tax in installments under section 6166 must provide a bond (or alternatively a special lien). The court found that it was Congress's intent that the IRS determine, on a case-by-case basis, that the government's interest is at risk prior to requiring security from an estate electing to pay the estate tax in installments under section 6166.

INTERIM PROVISIONS

The Treasury Department and the IRS are in the process of establishing standards to be applied on a case-by-case basis in the future to identify those estates making an election under section 6166 in which the government's interest in the deferred estate tax and the interest thereon is deemed to be sufficiently at risk to justify the requirement of a bond or special lien. The Treasury Department and the IRS intend to issue regulations implementing those standards and related procedures. Until those regulations are issued, however, the IRS will evaluate the factors described below

and all other relevant facts to determine on a case-by-case basis whether, at any time and from time to time during the deferral period, the government's interest in the estate tax deferred under section 6166 and interest thereon is sufficiently at risk to justify the requirement of a bond or special lien.

In order to determine whether the government's interest in the deferred tax is adequately secured up to the amount allowed under sections 6165 and 6324A, the IRS will consider information contained in the estate tax return, attachments to the return, information obtained during examination in audited cases, and any other relevant information described in paragraphs 1 through 3 of the discussion of the factors to be considered. Estates that have filed returns that do not contain adequate information to make this determination may be contacted and required to provide additional financial information to the IRS for purposes of making this determination. The IRS may terminate an estate's election for failure to respond to such requests within a reasonable timeframe. If, after this individual evaluation and analysis, the IRS determines there is a sufficient credit risk regarding the government's collection of the estate tax payments deferred under section 6166 and the interest thereon, the IRS will notify the estate that it must provide a bond or elect to provide a section 6324A special lien in lieu of a bond. If the estate then refuses to provide a bond or a section 6324A special lien, the IRS will terminate the estate's section 6166 election. The estate may then seek reconsideration of the termination by the Office of Appeals and, if the Office of Appeals upholds the IRS's determination, the estate then will have the opportunity to petition the Tax Court under section 7479 for a declaratory judgment with regard to whether its section 6166 election may be continued. I.R.C. § 7479; Rev. Proc. 2005–33, 2005–1 C.B. 1231.

The factors the IRS will consider in determining whether deferred installment payments of estate tax under section 6166 pose a sufficient credit risk to the government to justify the requirement of a bond or special lien are described below. In making this determination, the IRS will consider all relevant facts and circumstances, in addition to the factors identified in the following, non-exclusive list. No single factor will be determinative, and not all factors may be relevant to every estate.

1. *Duration and stability of the business.* This factor considers the nature of the closely held business on which the estate tax is deferred under section 6166 and of the assets of that business, the relevant market factors that will impact the business's future success, its recent financial history, and the experience of its management, in an effort to predict the likelihood of its success and survival through the deferred payment period. Facts relevant to this factor are likely to appear primarily in the appraisal and the financial statements that accompany the estate tax return. Information regarding any outstanding liens, judgments, or pending or anticipated lawsuits or other claims against the business, if any, that are not disclosed in that documentation should be provided by the estate with the election. The estate may be required to furnish such information in response to an inquiry by the IRS.

2. *Ability to pay the installments of tax and interest timely.* This factor considers how the estate expects to be able to make the annual payments of tax and interest as due, and the objective likelihood of realizing that expectation. Facts relevant to this factor may include the nature of the business's significant assets and liabilities, and the business's cash flow (both historical and anticipated). If not sufficiently disclosed in the documents attached to the estate tax return, the estate should submit relevant information with the election under section 6166. The estate may be required to furnish such information in response to an inquiry by the IRS.

3. *Compliance history.* This factor addresses the business's history regarding compliance with all federal tax payment and tax filing requirements, in an effort to determine whether the business and its management respect and comply with all tax requirements on a regular basis. This factor also addresses the estate's compliance history with respect to federal tax payment and filing requirements. The estate may use a sworn affidavit or other probative documents to provide this information.

This notice is applicable to each estate: (1) that timely elects to pay the estate tax in installments under section 6166 and that timely files a return on or after November 13, 2007; (2) whose return was being classified, surveyed or audited by the IRS as of April 12, 2007; or (3) that is currently in the deferred payment period but that has not yet provided a bond or special lien if (a) the general federal estate tax lien will expire within two years from November 13, 2007 or (b) the IRS reasonably believes that the government's interest in collecting the deferred estate tax and interest thereon in full is sufficiently at risk to require a bond or special lien.

REQUEST FOR COMMENTS

The Treasury Department and the IRS intend to issue regulations regarding the appropriate standards to be applied by the IRS in exercising its discretion with regard to whether a bond or special lien will be required in order to avoid an IRS termination of an estate's election under section 6166, and invite interested persons to submit comments regarding such standards and possible alternatives to a bond or special lien for providing security under section 6166.

In particular, comments are requested with regard to the following issues:

1. What factors, in addition to or in place of those stated above, should the IRS use in determining whether to require security from an estate electing to pay the estate tax in installments under section 6166?

2. How often during the section 6166 installment payment period (or on what occurrences) should the IRS reevaluate whether the estate poses a sufficient credit risk to the government's collection of the deferred estate tax and related interest to justify the requirement of a bond or special lien?

3. What facts evident from a review of the estate tax return are likely to be reasonably accurate predictors of either a future default in or full payment of the deferred tax payments and related interest?

4. What additional financial information should the IRS require from an estate to assist in making the determination as to whether the estate poses a sufficient credit risk to the government with regard to the deferred estate tax and interest thereon to justify requiring a bond or special lien?

5. For purposes of sections 6165 and 6166(k), should the IRS define a surety bond under section 7101 to also include other forms of security, and, if so, what other forms of security, such as certain

irrevocable letters of credit from reputable financial institutions or United States Treasury Bonds, should be so included?

Comments are encouraged to be submitted by January 14, 2008, to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2007–90), room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Notice 2007–90), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS e-mail address: *notice.comments@irscounsel.treas.gov.* Please include "Notice 2007–90" in the subject line of any electronic communication.

DRAFTING INFORMATION

The principal author of this notice is Laura Urich Daly of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Laura Urich Daly at (202) 622–3600 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Withholding Procedures Under Section 1441 for Certain Distributions to Which Section 302 Applies

REG–140206–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations regarding a withholding agent's obligation to withhold and report tax under Chapter 3 of the Internal Revenue Code when there is a distribution in redemption of stock of a corporation that is actively traded on an established financial market. Specifically, the proposed regulations provide an escrow procedure that a withholding agent must apply while making the determination under section 302 as to whether the distribution in redemption of the stock held by a foreign shareholder is treated as a dividend subject to withholding, or a distribution in part or full payment in exchange for stock. These regulations would affect corporations that are actively traded on an established financial market and their shareholders. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 16, 2008. Outlines of topics to be discussed at the public hearing scheduled for February 6, 2008 at 10 a.m. must be received by January 16, 2008.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–140206–06), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–140206–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–140206–06). The public hearing will be held in room 2140, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Kathryn Holman, (202) 622–3440 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, email *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Office for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 16, 2008. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance and purchase of service to provide information.

The collection of information in these proposed regulations is in §1.1441–3(c)(5)(iii). This information is required to allow a U.S. financial institution that is applying the escrow procedure to properly comply with its withholding and reporting obligations under sections 1441, 1442 and 1443 in the case of a distribution made by a corporation with respect to its stock that is actively traded on an established financial market and that requires a determination under section 302 as to whether the distribution is treated as a dividend or a distribution in part or full payment in exchange for stock. The collection of information is mandatory and the respondents are nonresident aliens and foreign corporations.

Estimated total annual reporting burden: 1400 hours.

The estimated annual burden per respondent: 2 hours.

Estimated number of respondents: 700.

Estimated annual frequency of responses: 5 times.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential as required by 26 U.S.C. 6103.

Background

These proposed regulations, REG–140206–06, provide guidance regarding the withholding and reporting obligations of a withholding agent under Chapter 3 of the Internal Revenue Code (Code) in the case of a distribution in redemption of the stock of a corporation that is actively traded on an established financial market within the meaning of §1.1092(d)–1 (publicly traded). In general the proposed regulations contemplate

a transaction where a publicly traded corporation offers to purchase stock from its shareholders (a self tender), where the amount of stock purchased and the shareholders involved in the transaction (the participating shareholders) depend on a number of factors, including each shareholder's willingness to sell some or all of its stock, and the terms set forth in the offer. The regulations would also apply to transactions described in section 304(a)(2).

In the case of a self-tender, a corporation may purchase stock from some or all of its shareholders and, as a result, each participating shareholder's percentage ownership interest in the corporation may increase, decrease, or remain the same. Although the corporation's self tender offer is denominated as an offer to purchase shares, the tax consequences to the corporation and any participating shareholder of the payment to such a shareholder, as described in this preamble, depend on several factors. Further, where the participating shareholder is a foreign person, withholding under Chapter 3 of the Code may or may not be required.

Sections 1441 and 1442 and §1.1441–1(b)(1) generally require a person that makes a payment of an "amount subject to withholding" to a beneficial owner that is a foreign person to deduct and withhold 30 percent of the payment unless the payor can reliably associate the payment with documentation upon which the payor can rely to treat the payment as made to a beneficial owner that is a U.S. person or as made to a beneficial owner that is a foreign person entitled to a reduced rate of withholding under the Code, regulations or an income tax treaty.

Section 1.1441–2(a) provides that the term *amounts subject to withholding* means amounts from sources within the United States that constitute fixed or determinable annual or periodical income (FDAP) described in §1.1441–2(b) or other amounts subject to withholding described in §1.1441–2(c).

Section 1.1441–2(b)(1) provides that FDAP includes all income described in section 61 of the Code, unless the item of income is described in §1.1441–2(b)(2). Section 1.1441–2(b)(2)(i) generally excludes from FDAP gains derived from the sale of property. Thus, a distribution to a shareholder that is treated as gain from the sale of stock is excluded from FDAP. Further, to the extent a distribution is a return of capital, it is not gross income under section 61, and thus also is not FDAP.

Section 302 provides rules for determining when a distribution in redemption of stock is treated as a distribution in part or full payment in exchange for stock. That section generally requires a comparison of a shareholder's overall interest in the corporation before the distribution and its overall interest in such corporation after the distribution. See section 302(b). In conducting the comparison, the constructive ownership rules of section 318 generally apply. If the shareholder's interest in the corporation has been sufficiently reduced, then the distribution is treated as a payment in exchange for the shareholder's stock under section 302(a). If the shareholder's interest in the corporation has not been sufficiently reduced, the tax consequences of the distribution are determined under section 301, and such distribution is a dividend to the shareholder to the extent the distribution is out of the distributing corporation's earnings and profits, then applied against and reduce the adjusted basis of the stock, and finally treated as gain from the sale or exchange of property. See section 301(c).

When a publicly held corporation makes a distribution in redemption of its stock, a determination must be made under section 302 with respect to each shareholder as to whether the redemption is treated as a distribution of property to which section 301 applies (potentially constituting a dividend in whole or in part) or as a distribution in part or full payment in exchange for stock. However, the information necessary for each shareholder to make such a determination generally is not available until after the transaction is completed because the redemption of stock held by other shareholders must be taken into account. Further, because of the application of the constructive ownership rules of section 318, when a distribution is made to a foreign shareholder, a withholding agent will often not be in the best position to make a determination as to whether the distribution to the foreign shareholder should be treated as a payment in exchange for the shareholder's stock or a dividend.

There are two revenue rulings that consider the issue of whether the interest of a shareholder in a publicly held corporation has been sufficiently reduced as a result of a distribution to effect exchange treatment under section 302(a).

In Rev. Rul. 76–385, 1976–2 C.B. 92, see §601.601(d)(2)(ii)(*b*), the IRS ruled that a shareholder who actually and constructively owned 0.0001118% of a publicly traded corporation's stock before a redemption, but only constructively owned 0.0001081% after the redemption, had experienced a "meaningful reduction in proportionate interest" in the corporation under the principles of *United States v. Davis*, 397 U.S. 301 (1970), rehearing denied, 397 U.S. 107 (1970). The shareholder's interest in the corporation after the redemption therefore was approximately 96.7% of the shareholder's interest before the redemption, taking constructive ownership into account. Nevertheless, the reduction was considered meaningful, and so the distribution to the shareholder was treated as not essentially equivalent to a dividend under section 302(b)(1) and as a payment in exchange for the shareholder's stock under section 302(a).

Consistent with Rev. Rul. 76–385, in Rev. Rul. 81–289, 1981–2 C.B. 82, see §601.601(d)(2)(ii)(*b*), the IRS ruled that a shareholder who owned 0.2% of the common stock of a publicly traded company before a redemption, and 0.2% of the common stock in the company after the redemption, did not satisfy the "meaningful reduction" standard of *United States v. Davis,* and that the redemption did not qualify for exchange treatment under section 302(a).

Under the analysis adopted in these revenue rulings, each minority shareholder who participates in a self tender must compute its percentage ownership of the total outstanding stock of the corporation before and after the transaction. If after the transaction the shareholder's percentage ownership is less than it was before the transaction, the shareholder generally has experienced a "meaningful reduction" in the shareholder's proportionate interest in the corporation, and the transaction, at least with respect to that shareholder, is considered a distribution in exchange for the stock under section 302(a) and not a distribution of property to which section 301 applies. This result occurs even if another participating shareholder in the same self tender experiences no change

or an increase in its percentage ownership of the corporation, and, therefore, is considered to receive a distribution of property to which section 301 applies. See also section 302(b)(2), (3), and (4).

Section 1.1441–3(c) requires a corporation making a distribution with respect to its stock to a foreign shareholder, as well as any intermediary (such as a broker) making a payment of such a distribution, to withhold on the entire amount of the distribution, unless it elects to reduce the amount of withholding under §1.1441–3(c). Section 1.1441–3(c)(2)(i)(B) provides that a distributing corporation or intermediary may elect to not withhold on a distribution to the extent it represents a distribution in part or full payment in exchange for stock. Section 1.1441–3(c)(2)(i) provides that a corporation or intermediary makes the election by reducing the amount of withholding at the time that the payment is made. However, a withholding agent cannot avail itself of this election unless it knows the extent to which a distribution represents a payment in exchange for stock under section 302(a). As previously noted, in the context of a distribution in redemption of stock held in a publicly traded corporation, the withholding agent generally will not have this information unless, at the time of the redemption, it has obtained information from each participating shareholder regarding actual and constructive ownership of stock for purposes of the foregoing analysis.

The Treasury Department and the IRS are aware that, in the context of transactions involving distributions in redemption of stock held by foreign persons where such stock is actively traded on an established financial market, the means of compliance with sections 1441, 1442, and 1443 is varied. The Treasury Department and the IRS believe that the discretion permitted by the current regulations, and the resulting different treatment of similar transactions is not appropriate. Accordingly, these proposed regulations provide the procedure ("escrow procedure") to be followed by U.S. withholding agents to satisfy the withholding, reporting and deposit requirements of the regulations under sections 1441, 1442, and 1443 with respect to any payment of a corporate distribution in redemption of stock made to a foreign account holder with respect to certain self tenders.

Explanation of Provisions

The proposed regulations set forth an escrow procedure for withholding agents to follow in the case of a payment made after December 31, 2008 of a corporate distribution in redemption of stock that is actively traded on an established financial market within the meaning of §1.1092(d)–1 (section 302 payment).

In general, the proposed regulations require a U.S. financial institution (withholding agent) to set aside in an escrow account 30 percent (or the applicable dividend rate provided under a treaty) of the amount of the section 302 payment. The withholding agent is then required to provide information to the foreign beneficial owner regarding the distribution, including the total number of the distributing corporation's shares outstanding before and after the distribution. The withholding agent must also provide a written statement explaining the conditions under which the section 302 payment will be treated as a dividend or a payment in exchange for stock (including an explanation of the constructive ownership rules under section 318). In the written explanation provided to the foreign beneficial owner, the withholding agent must request that the beneficial owner provide a written certification to the withholding agent within 60 days as to whether the distribution is either a dividend or a payment in exchange for stock.

The certification to be provided by the foreign beneficial owner must contain, among other requirements, the beneficial owner's name and account number, a certification that the distribution is a payment in exchange for stock or is a dividend, and the number of shares actually and constructively owned by the beneficial owner before and after the distribution. The beneficial owner's certification must be signed under penalties of perjury.

A withholding agent may generally rely on a certification received from a foreign beneficial owner in determining its section 1441 obligations with respect to payments for such beneficial owner's stock. However, if the withholding agent knows or has reason to know that the certification is unreliable or incorrect, or the withholding agent does not receive a certification from a foreign beneficial owner, the withholding agent is required to treat the amount set aside in escrow as tax withheld on the 61st day, and deposit that amount pursuant to the applicable regulations.

Although a qualified intermediary (QI) may, and a withholding foreign partnership and a withholding foreign trust (WP/WT) must, assume primary withholding responsibility under section 1441 and receive payments without any withholding by the U.S. financial institution, under the proposed regulations, in the case of a section 302 payment, the QI or WP/WT cannot assume primary withholding responsibility and receive the payment in gross. The QI or WP/WT must apply the procedure described in this preamble and provide the U.S. financial institution with a withholding statement that details the appropriate rate of withholding and information reporting for amounts paid to the QI or WP/WT. In addition, if there is a chain of QIs or WPs/WTs this procedure must be followed at each level in the chain. The U.S. financial institution shall treat beneficial owners that are U.S. non-exempt recipients, and that hold stock in the distributing corporation through QIs, WPs/WTs, NQIs and flow-throughs, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

These proposed regulations would apply for redemptions of stock that are made after December 31, 2008. However, a withholding agent may, at its option, rely on these proposed regulations for a redemption of stock that occurs before January 1, 2009.

The Treasury Department and the IRS are aware that withholding agents serve various customer bases: some may maintain accounts for a small number of account holders, others may maintain accounts for a much greater number of account holders. Comments are requested on alternatives to the escrow procedure described in this proposed regulation for withholding agents that maintain accounts for large numbers of customers.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

These regulations impose a collection of information on small entities, and the Regulatory Flexibility Act (5 U.S.C. chapter 6) applies. This rule regulates securities brokerages that have foreign customers that respond to a tender offer by a U.S. publicly traded corporation to purchase some of its stock from its shareholders. The Small Business Administration (SBA) has established size standards for types of economic activities which are classified based on the North American Industry Classification Codes (NAICS). The regulations specifying size standards are set forth in Title 13, Code of Federal Regulations, part 121 (13 CFR part 121), Small Business Size Regulations. The NAICS Code for a small securities brokerage is specified at 13 CFR 121.201. Pursuant to subsector 523120 of the NAICS, a small securities brokerage is one with receipts of less than 6.5 million dollars. According to NAICS 523120, U.S. Census Bureau, Statistics of U.S. Business (2002), there are a total of 7,886 securities brokerages of which 7,113 generate revenue less than $5 million and 224 generate revenue between $5 million and $10 million. It is estimated that 7,213 of the securities brokerages are considered small businesses. The IRS requests information regarding the number of transactions these small securities brokerages engage in each year involving self tenders by public corporations. In the case of a tender offer by a publicly held corporation, it is estimated that a brokerage clerk would spend two hours preparing the paperwork and verifying the computations required to accurately withhold with respect to foreign customers. According to the Bureau of Labor Statistics, the mean hourly wage of a brokerage clerk is $18.34, so it is estimated that it will cost a small securities brokerage $36.68 per transaction. This cost is not significant when compared to the annual revenue of the small securities brokerage. Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. §605, the Chief Counsel certifies that this rule will not have a significant economic impact on a substantial number of small entities. The IRS invites specific comments on the economic impact of compliance from members of the public who believe there will be a significant economic impact on small businesses that are regulated by this rule. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 6, 2008, beginning at 10 a.m. in room 2140 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 12th street entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments, and an outline of the topics to be discussed, and the time to be devoted to each topic (signed original and eight (8) copies) by January 16, 2008. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Kathryn Holman, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1441–3 is amended as follows:

1. A sentence is added at the end of paragraph (c)(2)(i)(B).
2. Paragraph (c)(5) is added.
3. A sentence is added at the end of paragraph (d)(1).

The additions read as follows.

§1.1441–3 Determination of amounts to be withheld.

* * * * *

(c) * * *

(2) * * *

(i) * * *

(B) * * * The preceding sentence shall not apply to a public section 302 distribution to which paragraph (c)(5) applies.

* * * * *

(5) *Special rules for certain distributions to which section 302 applies*—(i) *Withholding responsibility*— (A) *General rule*. A corporation that makes a public section 302 distribution, or any intermediary (described in §1.1441–1(c)(13)) making a payment of such a distribution, is required to withhold under section 1441, 1442 or 1443 on the entire amount of the distribution unless the provisions of paragraph (c)(5)(iii) of this section have been applied. The provisions of paragraph

(c)(2)(i)(B) or (d)(1) of this section do not apply to a public section 302 distribution.

(B) *Effective/applicability date.* The rules of this paragraph (c)(5) apply to public section 302 distributions made after December 31, 2008.

(ii) *Definitions.* Solely for purposes of this paragraph (c)(5), the following definitions shall apply:

(A) *Public section 302 distribution* means a distribution by a corporation in redemption of its stock for which there is an established financial market within the meaning of §1.1092(d)–1.

(B) *Section 302 payment* means payment of a public section 302 distribution.

(C) *Distributing corporation* means a corporation making or treated as making a public section 302 distribution.

(iii) *Escrow procedure*—(A) *Application*—(*1*) *In general.* The escrow procedure in this paragraph (c)(5)(iii) may be applied only by an intermediary (described in §1.1441–1(c)(13)) that is a U.S. financial institution. A U.S. financial institution making a section 302 payment to a foreign account holder, and applying this escrow procedure, is not required to withhold on the entire amount of a section 302 payment under the general rule of paragraph (c)(5)(i).

(B) *Escrow account*—(*1*) *In general.* A U.S. financial institution shall set aside in an escrow account on the date it receives a section 302 payment from a distributing corporation with respect to stock of a foreign account holder 30 percent (or the applicable dividend rate provided by a tax treaty for a qualifying foreign account holder) of the amount and shall credit the foreign account holder's account with the balance of the section 302 payment.

(*2*) *Qualified intermediaries.* The amount set aside, under paragraph (c)(5)(iii)(B)(*1*) of this section shall include 30 percent (or the applicable dividend rate provided by a treaty) of the amount paid to any qualified intermediary (QI) (whether or not the QI has assumed primary withholding responsibility) and to any withholding foreign partnership or withholding foreign trust (WP/WT).

(C) *Request for section 302 payment certification.* On or before the date it receives the section 302 payment, the U.S. financial institution shall provide the following information and instructions, in writing, to the foreign beneficial owner—

(*1*) The total number of distributing corporation's shares outstanding before and after the public section 302 distribution;

(*2*) An explanation of the conditions under which the section 302 payment will be treated as a dividend or a payment in exchange for stock for Federal income tax purposes (including an explanation of any applicable constructive ownership rules); and

(*3*) A request that the beneficial owner of the account provide a certification (section 302 payment certification), within 60 days of the section 302 payment, stating whether the section 302 payment is either a dividend or a payment in exchange for stock under the Internal Revenue Code.

(D) *Content of section 302 payment certification.* The section 302 payment certification must include the following information:

(*1*) The beneficial owner's name and account number.

(*2*) The distributing corporation's name.

(*3*) The total shares of the distributing corporation outstanding immediately before and immediately after the public section 302 distribution.

(*4*) A certification from the beneficial owner that either—

(*i*) The section 302 payment is a payment in exchange for stock because the beneficial owner's proportionate interest has been reduced but not completely terminated;

(*ii*) The section 302 payment is a payment in exchange for stock because the beneficial owner's interest in the distributing corporation is completely terminated; or

(*iii*) The section 302 payment is a dividend.

(*5*) With respect to the certifications in paragraph (c)(5)(iii)(D)(*4*)(*i*) and (*ii*) of this section, the number of shares actually and constructively owned by the beneficial owner before and after the distribution and the beneficial owner's percentage ownership before and after the distribution.

(*6*) A penalties of perjury statement.

(*7*) The signature of the beneficial owner and date of signature.

(E) *Receipt of section 302 payment certification*—(*1*) *Payment in exchange for stock.* If, within the 60-day period described in paragraph (c)(5)(iii)(C)(*3*), the U.S. financial institution receives from the foreign beneficial owner a section 302 payment certification stating that the section 302 payment is a payment in exchange for stock, and if the U.S. financial institution does not know or have reason to know that the information in the section 302 payment certification is unreliable or incorrect, the U.S. financial institution shall credit the account with the amount set aside with respect to the beneficial owner who provides the certification. The entire amount paid (including the amount initially set aside) shall be reported as capital gains on Form 1042–S, *Foreign Person's U.S. Source Income Subject to Withholding.*

(*2*) *Unreliable or incorrect exchange certification.* If the U.S. financial institution knows or has reason to know that the information in the section 302 payment certification is unreliable or incorrect, the U.S. financial institution shall treat the payment as a payment for which no section 302 payment certification has been received and shall follow the withholding and reporting procedures in paragraph (c)(5)(iii)(E)(*4*) of this section.

(*3*) *Dividend.* If, within the 60-day period, the U.S. financial institution receives a section 302 payment certification from the foreign beneficial owner stating that the section 302 payment is a dividend, the U.S. financial institution shall treat the amount set aside as tax withheld as of the time it receives the section 302 payment certification, and shall deposit that amount pursuant to the applicable regulations. The entire amount paid shall be reported on Form 1042–S as dividends.

(*4*) *No timely certification received.* If, within the 60-day period, the U.S. financial institution does not receive a section 302 payment certification, or is treated under paragraph (c)(5)(iii)(E)(*2*) of this section as not receiving a section 302 payment certification, the U.S. financial institution shall treat the amount set aside as tax withheld as of the 61st day, and shall deposit that amount pursuant to the applicable regulations. The entire amount paid shall be reported on Form 1042–S as dividends.

(*5*) *Late certification.* If, after the 60-day period has expired, the U.S. financial institution receives a section 302 payment certification from a foreign beneficial owner that the section 302 payment is a payment in exchange for stock and the conditions stated in §1.1461–2(a) are

satisfied, the U.S. financial institution may apply the refund or offset procedures of that paragraph.

(*6*) *Determination of incorrect treatment.* If, after the 60-day period has expired, the U.S. financial institution determines that the section 302 payment was incorrectly treated as a distribution in exchange for stock, the procedures set forth regarding underwithholding in §1.1461–2(b) are applicable.

(*7*) *Undocumented beneficial owners.* The U.S. financial institution shall withhold at 30 percent on the entire amount paid to a beneficial owner that is not properly documented under §§1.1441–1, 1.1441–5, etc. and that is presumed to be a foreign person, whether or not the U.S. financial institution has received a section 302 payment certification from such beneficial owner. The U.S. financial institution shall report the entire amount paid on Form 1042–S as dividends.

(F) *Amounts in excess of section 302 payment.* If the amount the U.S. financial institution credits to the account of the foreign beneficial owner from the escrow account includes an amount in excess of the section 302 payment, such as interest accrued on the escrowed funds, the U.S. financial institution shall report and withhold on such excess amount in accordance with the rules under Chapter 3 of the Internal Revenue Code.

(G) *U.S. non-exempt recipients.* The U.S. financial institution shall treat beneficial owners that are U.S. non-exempt recipients, and that hold stock in the distributing corporation through QIs, WPs/WTs, NQIs and flow-throughs, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

(H) *Notice to distributing corporation.* The U.S. financial institution shall notify the distributing corporation, in writing, by the filing date of Form 1042–S, of the aggregate amount of the section 302 payment that the U.S. financial institution has reported on Forms 1042–S as capital gains, and the aggregate amount of the section 302 payment that it has reported on Forms 1042–S as dividends.

(I) *Application of Escrow Procedure to Qualified Intermediaries.* As provided in paragraph (c)(5)(iii)(A) of this section, only the U.S. financial institution may establish an escrow account and the amounts set aside in the escrow account shall include 30 percent (or the applicable treaty rate applicable to dividends) on payments made to a direct account holder that is a QI (including a QI that has assumed primary withholding responsibility). Under the procedure described in paragraph (c)(5)(iii)(I)(*3*), a QI shall provide the U.S. financial institution with a withholding statement as required in the QI Agreement. If there is a chain of QIs, each QI in the chain shall apply the procedure. The procedures described in this paragraph (I) shall be applied to withholding foreign partnerships and withholding foreign trusts within the meaning of §§1.1441–5(c)(2) and (e)(5)(v), respectively, in the same manner as the procedures apply to a QI.

(*1*) *Request for section 302 payment certification.* The U.S. financial institution shall provide the information and instructions described in paragraph (c)(5)(iii)(C) of this section to the QI, and the QI shall provide the same information and instructions to its account holders including account holders that are U.S. non-exempt recipients.

(*2*) *Content of section 302 payment certification.* The content of the section 302 payment certification shall include the information described in paragraph (c)(5)(iii)(D) of this section.

(*3*) *Receipt of section 302 payment certification—(i) Payment in exchange for stock.* If, within the 60-day period described in paragraph (c)(5)(iii)(C), the QI receives from the beneficial owner a section 302 payment certification stating that the section 302 payment is a payment in exchange for stock and if the QI does not know or have reason to know that the information in the section 302 payment certification is unreliable or incorrect, the QI shall reflect such treatment in its withholding statement provided to the U.S. financial institution, and, based upon the withholding statement, the U.S. financial institution shall release payment from its escrow and the QI shall credit the beneficial owner's account with the amount set aside by the U.S. financial institution with respect to the beneficial owner who provided the certification. The entire amount paid (including the amount initially set aside) shall be reported on the QI's pooled basis Form 1042–S as capital gains.

(*ii*) *Unreliable or incorrect exchange certification.* If the QI knows or has reason to know that the information in the section 302 payment certification is unreliable or incorrect, the QI shall treat the payment as a payment for which no section 302 payment certification has been received and shall follow the withholding and reporting procedures in paragraph (c)(5)(iii)(I)(*3*)(*iv*) of this section.

(*iii*) *Dividend.* If, within the 60-day period, QI receives a section 302 payment certification stating that the section 302 payment is a dividend, the QI shall reflect such treatment in its withholding statement and shall treat the payment as a dividend for purposes of its reporting and withholding responsibilities under the QI agreement. The entire amount paid shall be reported on its pooled basis Form 1042–S as dividends.

(*iv*) *No timely certification received.* If, within the 60-day period, the QI does not receive a section 302 payment certification, or is treated under paragraph (c)(5)(iii)(I)(*3*)(*ii*) of this section as not receiving a section 302 payment certification, the QI shall reflect such treatment in its withholding statement provided to the U.S. financial institution and shall treat the payment as a dividend for purposes of its reporting and withholding responsibilities under the QI agreement. The entire amount paid shall be reported on its pooled basis Form 1042–S as dividends.

(*v*) *Late certification.* If, after the 60-day period has expired, the QI receives a section 302 payment certification from a beneficial owner that the section 302 payment is a payment in exchange for stock and the conditions stated in the QI agreement regarding the refund and offset procedures are satisfied, the QI may apply such refund or offset procedures.

(*vi*) *Determination of incorrect treatment.* If, after the 60-day period has expired, the QI determines that the section 302 payment was incorrectly treated as a distribution in exchange for stock, the procedures set forth regarding adjustments for underwithholding in the QI agreement are applicable.

(*vii*) *Undocumented beneficial owners.* The QI shall withhold at 30 percent on the entire amount paid to a beneficial owner that is not properly documented and that is

presumed to be a foreign person, whether or not the QI has received a section 302 payment certification from such beneficial owner. The QI shall report the entire amount paid on its pooled basis Form 1042–S as dividends.

(*4*) *U.S. non-exempt recipients.* The QI shall treat direct account holders that are U.S. non-exempt recipients, and that hold stock in the distributing corporation, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

(J) *Intermediaries that are not qualified intermediaries.* If the U.S. financial institution has an account holder that is an intermediary that is not a QI ("NQI"), the U.S. financial institution shall apply the rules of paragraph (c)(5)(iii)(J)(*1*) through (*4*) of this section. Where the provisions of this paragraph (J) refer only to the U.S. financial institution, they shall apply in the same manner to a QI or WP/WT and where they refer to an NQI, they shall apply in the same manner to a flow-through that is not a WP or WT.

(*1*) The U.S. financial institution shall provide the information and instructions described in paragraph (c)(5)(iii)(C) of this section to the NQI and the NQI shall provide the same information and instructions to its account holders.

(*2*) The content of the section 302 payment certification shall include the information described in paragraph (c)(5)(iii)(D) of this section.

(*3*) The NQI shall provide the section 302 payment certification to the U.S. financial institution together with the otherwise required documentation and a withholding statement made in accordance with the section 302 payment certification.

(*4*) The U.S. financial institution shall treat the section 302 payment as a dividend or a payment in exchange for stock based on the information and documentation provided to it under paragraph (c)(5)(iii)(J)(*3*) of this section. The U.S. financial institution shall withhold and report on a specific payee basis in accordance with this information.

(d) * * * (1) * * * This paragraph does not apply to a public section 302 distribution to which paragraph (c)(5) applies.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 16, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2007, 72 F.R. 58781)

Notice of Proposed Rulemaking

Compensation for Labor or Personal Services: Artists and Athletes

REG–114125–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed changes to existing final regulations regarding the source of compensation for labor or personal services. The proposed changes are needed to clarify the determination of source of compensation of a person, including an artist or athlete, who is compensated for labor or personal services performed at specific events. These proposed regulations affect such an individual.

DATE: Written or electronic comments and requests for a public hearing must be received by January 14, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–114125–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–114125–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS–REG–114125–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Bergkuist at (202) 622–3850; concerning the submissions of comments and requests for a hearing, Regina Johnson at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments under 26 CFR part 1 under section 861 of the Internal Revenue Code (Code). On July 14, 2005, final regulations that revised and amended §1.861–4 were published in the **Federal Register** (70 FR 40663) as T.D. 9212, 2005–2 C.B. 429. In these final regulations, §1.861–4(b)(2)(ii)(C)(*3*) was reserved with respect to compensation for labor or personal services performed partly within and partly without the United States by an artist or an athlete who is an employee.

Section 861(a)(3) of the Internal Revenue Code provides that, subject to certain exceptions, compensation for labor or personal services performed in the United States is gross income from sources within the United States. See also §1.861–4(a) of the regulations. Section 862(a)(3) of the Code provides that compensation for labor or personal services performed without the United States is gross income from sources without the United States. Section 1.861–4(b) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States. Section 1.861–4(b)(2)(i) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States by an individual other than as an employee. Section 1.861–4(b)(2)(ii) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States by an individual as an employee.

Under §1.861–4(b)(2)(ii), if an individual performs labor or personal services as an employee, the source of the individual's compensation is generally determined on a time basis, with certain fringe benefits sourced on a geographic basis. An individual may determine the source of his or her compensation as an employee for labor or personal services performed partly within and partly without the United States

under an alternative basis if the individual establishes to the satisfaction of the Commissioner that, under the facts and circumstances of the particular case, the alternative basis more properly determines the source of the compensation than the general rules of §1.861–4(b)(2)(ii). See §1.861–4(b)(2)(ii)(C)(*1*)(*i*). In addition, the Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee under an alternative basis if such compensation is not for a specific time period, provided that the Commissioner's alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual.

The final regulations at §1.861–4(b)(2)(ii)(C)(*3*) provided a reservation with respect to the source of compensation for labor or personal services performed partly within and partly without the United States by an artist or athlete who is an employee. The preamble of T.D. 9212 indicated that it was intended that the rule for artists and athletes who are employees, when issued, would require such individuals to determine the proper source of their compensation for labor or personal services on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case, consistent with current law.

Explanation of Provisions

The proposed regulations would set forth a new "events basis" rule in §1.861–4(b)(2)(ii)(G) and make certain other clarifying changes to the existing final regulations. The proposed regulations also would remove §1.861–4(b)(2)(ii)(C)(*3*), which reserved with respect to artists and athletes.

The amount of income received by a person, including an individual who is an artist or an athlete, that is properly treated as compensation from the performance of labor or personal services is determined based on all of the facts and circumstances of the particular case. Proposed §1.861–4(b)(2)(ii)(G) specifies that the amount of compensation for labor or personal services determined on an event basis is the amount of the person's compensation which, based on the facts and circumstances, is attributable to the labor or personal services performed at the location of a specific event.

The IRS and the Treasury Department have determined that the proper source of compensation received by a person, including an individual who is an artist or athlete, specifically for performing labor or personal services at an event is the location of the event. A basis that purports to determine the source of compensation from the performance of labor or personal services at a specific event, whether on a time basis or otherwise, by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly determines the source of the compensation. This rule applies to situations covered by §1.861–4(a) and (b).

Under §1.861–4(a), the source of compensation for labor or personal services performed wholly within the United States is generally from sources within the United States. Therefore, if a person, including an individual who is an artist or an athlete, is specifically compensated for performing labor or personal services at an event in the United States, the source of such compensation is wholly within the United States because the labor or personal services were performed wholly at an event within the United States. The proposed regulations state that a basis that purports to determine the source of such income on a time basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be a more reasonable basis for determining source of the compensation. The proposed regulations add an example to §1.861–4(c) to illustrate the application of this rule.

Section 1.861–4(b) applies to instances in which a person is compensated for performing labor or personal services at multiple events, only some of which are within the United States, and at least a portion of the person's compensation cannot be specifically attributed to the person's performance of labor or personal services at a specific location. If the person is not an individual who is compensated as an employee, the source of compensation for labor or personal services is determined on the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case. See §1.861–4(b)(1) and (2)(i). If a person is compensated specifically for labor or personal services performed at multiple events, the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case will generally be the location of the events. In addition, a basis that purports to determine the source of such income on a time basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly reflects the proper source of the compensation under proposed §1.861–4(b)(2)(ii)(G).

The Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee under an alternative basis if such compensation is not for a specific time period, provided that the Commissioner's alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual. Compensation specifically for labor or personal services performed at a specific event is not compensation for a specific time period. The basis that most correctly reflects the proper source of that income will generally be the location of the event under proposed §1.861–4(b)(2)(ii)(G). In addition, a basis that purports to determine the source of such income on a facts and circumstances basis by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not more properly determine the source of the compensation under proposed §1.861–4(b)(2)(ii)(G).

These proposed regulations provide examples to illustrate the event basis for determining the source of compensation of an individual, including an artist or athlete, who is compensated specifically for performing labor or personal services at an event.

The revisions to §1.861–4(b)(1), (b)(2)(i), and (b)(ii)(C)(*1*)(*i*) and (*ii*) which refer to the event basis; the revisions in §1.861–4(b)(2)(ii)(C)(*3*), (b)(2)(ii)(E),

and (b)(2)(ii)(F), (b)(2)(ii)(G), and (c); and new *Examples 7* through *11* of §1.861–4(c) would be effective for taxable years beginning after the date final regulations are published in the **Federal Register**.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comment that is submitted timely to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for a public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is David Bergkuist, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.861–4 is amended by:

1. Removing the heading for paragraph (b)(1)(i).

2. Redesignating paragraph (b)(1)(i) as paragraph (b)(1).

3. In the last sentence of newly designated paragraph (b)(1), adding the language "or on the event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "paragraph (b)(2)(ii)(E) of this section,".

4. In the last sentence of paragraph (b)(2)(i), adding the language "or on the event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "paragraph (b)(2)(ii)(E) of this section,".

5. In the first sentence of paragraph (b)(2)(ii)(C)(*1*)(*i*), adding the language ", including an event basis as defined in paragraph (b)(2)(ii)(G) of this section," after the language "alternative basis" wherever the language "alternative basis" appears in the sentence.

6. In the first sentence of paragraph (b)(2)(ii)(C)(*1*)(*ii*), adding the language "event basis as defined in paragraph (b)(2)(ii)(G) of this section or other" after the language "partly without the United States under an".

7. Removing paragraph (b)(2)(ii)(C)(*3*).

8. In the first sentence of paragraph (b)(2)(ii)(E), removing the language "individual's" and adding the language "person's" in its place, removing the language "individual" and adding the language "person" in its place, and removing the language "his or hers" and adding the language "such person's" in its place.

9. In the second sentence of paragraph (b)(2)(ii)(F), removing the language "an individual" and adding the language "a person" in its place.

10. Redesignating paragraphs (c) and (d) as new paragraphs (d) and (e), respectively.

11. Redesignating paragraph (b)(2)(ii)(G) as new paragraph (c).

12. Adding a new paragraph (b)(2)(ii)(G).

13. In the introductory language of newly-designated paragraph (c), removing the language "paragraph (b)(2)(ii)" and adding the language "section" in its place.

14. Adding new *Examples 7, 8, 9, and 10* to newly-designated paragraph (c).

15. Redesignating paragraph (b)(1)(ii) *Example*, as new *Example 11* in newly-designated paragraph (c), revising the paragraph heading and removing paragraph (b)(1)(ii).

16. Adding a new sentence at the end of newly-designated paragraph (e) and revising the paragraph heading.

The additions read as follows:

§1.861–4 Compensation for labor or personal services.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(G) *Event basis.* The amount of compensation for labor or personal services determined on an event basis is the amount of the person's compensation which, based on the facts and circumstances, is attributable to the labor or personal services performed at the location of a specific event. The source of compensation for labor or personal services determined on an event basis is the location of the specific event. A basis that purports to determine the source of compensation from the performance of labor or personal services at a specific event, whether on a time basis or otherwise, by taking into account the location of labor or personal services performed in preparation for the performance of labor or personal services at the specific event will generally not be the basis that most correctly determines the source of the compensation.

(c) *Examples.* * * *

Example 7. P, a citizen and resident of Country A, is paid by Company Z to make a presentation in the United States in 2009. In 2010, Company Z pays P to make 10 presentations, four of which are in the United States and six of which are outside the United States. P is compensated separately by Company Z for each presentation. For some presentations P receives a flat fee from Company Z. For the remaining presentations P receives compensation that is based on a formula. Under the facts and circumstances of the particular case, the source of the compensation

for each presentation is most correctly reflected on an event basis, as defined in paragraph (b)(2)(ii)(G) of this section. Because P is compensated separately for each presentation, the source of P's compensation from Company Z for the 2009 presentation within the United States and the four 2010 presentations in the United States will be from sources in the United States. The amounts will be determined based on the flat fee or the formula as contractually determined.

Example 8. (i) *Facts.* Group B, a Country N corporation, is a musical group. All of the members of Group B are citizens and residents of Country N. Group B has an employment arrangement with Corp Y, a Country N corporation, to perform as directed by Corp Y. Corp Y and a tour promoter enter into a contract to provide the services of Group B to perform in musical concerts in the United States and Country M during a 45-day period. Under the contract, Group B performs concerts in 15 cities, 10 of which are in the United States. Prior to entering the United States, Group B spends 60 days rehearsing and preparing in Country N. Under the contract with Corp Y, Group B receives a flat fee of $10,000,000 for performing in all 15 cities. The fee is based on expected revenues from the musical concerts. Each concert is expected to require a similar amount and type of labor or personal services by Group B. At the end of the tour, an analysis of the revenues from all of the concerts shows that 80% of the total revenues from the tour were from the performances within the United States.

(ii) *Analysis.* Under the facts and circumstances basis of paragraph (b)(1) of this section, the source of the compensation received under the contract is most correctly reflected on an event basis, as defined in paragraph (b)(2)(ii)(G) of this section, with amounts determined based on the relative gross receipts attributable to the performances within and without the United States. Thus, of the $10,000,000 of compensation included in Group B's gross income, $8,000,000 ($10,000,000 X .80) is attributable to labor or personal services performed by Group B within the United States and $2,000,000 ($10,000,000 X .20) is attributable to the labor or personal services performed by Group B without the United States.

Example 9. (i) *Facts.* A, a citizen and resident of Country M, is an employee of Corp X, a Country M corporation. During 2008, Corp X is contractually obligated to provide A's services to perform in a specific athletic event in the United States. Under A's employment contract with Corp X, A is required to perform at a professional level that requires training and other preparation prior to the event. A undertakes all of this preparation in Country M. Solely as a result of A's performance at the athletic event in the United States, A receives $2,000,000 from Corp X.

(ii) *Analysis.* The entire $2,000,000 received by A for performing labor or personal services at the athletic event in the United States is income from sources within the United States on an event basis as defined in paragraph (b)(2)(ii)(G) of this section. A's compensation is attributable entirely to labor or personal services performed within the United States at the athletic event. It is inappropriate to conclude that the source of A's compensation for labor or personal services is performed partly within and partly without the United States simply because A's preparation for the athletic event involved activities in Country M.

Example 10. (i) *Facts.* X, a citizen and resident of Country M, is employed under a standard player's contract by a professional sports team (Team) that plays its games both within and without the United States during its season. The term of the contract is for twelve months beginning on October 1. Under the contract, X's salary could be paid in semi-monthly installments beginning with the first game of the regular season and ending with the final game played by the Team. Alternatively, because the regular playing season was shorter than the one-year period covered by the contract, X had the option to receive his salary over a twelve-month period. X elected this option. In addition, during the period of this employment contract, X, as an employee of Team, was required to practice at the direction of the Team as well as to participate in games. During 2008, X participated in all practices and games of Team and received a salary. Team qualified for postseason games in 2008. X also received in 2008 additional amounts for playing in preseason and postseason games for the Team.

(ii) *Analysis.* The salary paid to X by the Team is considered to be personal services compensation of X that X received as an employee of the Team. The source of this compensation within the United States is determined under the time basis method described in paragraph (b)(2)(ii)(A) of this section and accordingly is determined based upon the number of days X performed services for the Team within the United States during 2008 over the total number of days that X performed services for the Team during 2008. The source of the additional amounts X received for playing in preseason and postseason games is determined under the event basis method described in paragraph (b)(2)(ii)(G) of this section and accordingly is determined based on the location where each such preseason or postseason game was played.

Example 11. * * *

* * * * *

(e) *Effective/applicability date.* * * * The revisions in paragraphs (b)(1), (b)(2)(i), and (b)(2)(ii)(C)(*1*)(*i*) and (*ii*) of this section which refer to the event basis; the revisions of paragraphs (b)(2)(ii)(C)(*3*), (b)(2)(ii)(E), (b)(2)(ii)(F), (b)(2)(ii)(G), and (c) of this section; and *Examples 7* through *11* of paragraph (c) of this section apply to taxable years beginning after the date final regulations are published in the **Federal Register**.

Linda E. Stiff,
Deputy Commissioner
for Services and Enforcement.

(Filed by the Office of the Federal Register on October 16, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2007, 72 F.R. 58787)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-104

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will

continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007

Name	Address	Designation	Date of Suspension
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007

Name	Address	Designation	Date of Suspension
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007

Name	Address	Designation	Date of Suspension
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Request for Applications to Participate in the 2008 IRS Individual *e-file* Partnership Program

Announcement 2007–106

The Stakeholder Partnerships, Education and Communication (SPEC) organization within the Internal Revenue Service (IRS) is continuing its efforts to establish IRS *e-file* partnerships with various entities. The IRS is seeking non-monetary e-file partnerships for Filing Season 2008. No applications for funding (monetary compensation) will be considered. A commercial business, non-profit organization, state government or local government may submit applications. Applications are not solicited from other Federal government agencies. The program is an annual program and covers the period **January through October 15, 2008**. **All prior year partners must reapply for Filing Season 2008.**

BACKGROUND

The IRS Restructuring and Reform Act of 1998 (RRA 98) authorized the IRS Commissioner to promote the benefits of and encourage the use of e-file services. RRA 98 enables the IRS to enter into non-monetary partnerships with businesses to offer low cost income tax preparation and electronic filing for qualified taxpayers.

Continued opportunities for growth in electronic tax administration are evident. For Filing Season 2007, the IRS received 80 million electronically filed returns, an increase of 9% over the previous year. Visit the IRS web site, ***http://www.irs.gov***, for the most current results from market research on individual taxpayers, including demographic data and psychographic studies. This research includes attitudinal surveys, customer satisfaction surveys, Public Service communications, tracking studies and any focus group results.

The IRS accepts many forms and schedules for electronic filing. Visit the IRS.gov for a complete listing of accepted forms and schedules.

FILING SEASON 2008

For Filing Season 2008, the IRS will continue to focus on the 1040 series income tax returns covering "IRS *e-file* Using a Tax Preparer" and "IRS *e-file* Using a Personal Computer." Additional emphasis continues to be placed on the following features: electronic signature options, Federal/State e-file, and electronic payment options for balance due and estimated payment options.

A major area of emphasis is to reach those taxpayers who continue to file computer prepared paper returns (v-code). Research indicates that the number of v-code returns continues to increase (76% of all v-code returns are prepared by paid preparers). Emphasis should be placed on converting v-code filers to electronically file their returns through advertising the benefits of e-file.

Participants should also reach those individuals eligible for the Earned Income Tax Credit (EITC). It's important to note that military families may qualify for EITC since supplemental payments and combat pay are exempt from the income calculations.

Participants are encouraged to focus on reducing the number of errors made on electronically filed returns, including those returns claiming EITC. The "EITC Assistant" is an interactive web-based tool designed to help tax professionals determine whether or not their clients are eligible for EITC, and why. The "EITC Assistant" is a step taken by the IRS to maximize taxpayer participation, minimize EITC errors while increasing compliance. You can find the "EITC Assistant" on the IRS web site at ***http://www.irs.gov/eitc***.

The Hispanic population is the fastest growing minority segment in the U.S. Participants are encouraged to market their e-file services to this segment of the population and offer the Spanish versions for online filing and/or downloadable software.

The IRS expects all accepted partners to market, promote and offer e-file product and services through October 15, 2008. The IRS will supply the partners with the key marketing messages that support electronic filing during the Filing Season (January through April 15, 2008) and post-Filing Season (April through October 15, 2008). These messages should be used in your promotion of electronic filing and displayed on the web sites of Participants. Utilization of these messages will ensure uniformity and maximize public awareness. For additional information on the various e-file programs, features, and market research, visit the IRS web site at ***http://www.irs.gov***.

Participants will receive hyperlinks from IRS.gov (Partners Page) — to the

Participant's web site. Potential Participants may request links for the following categories:

- IRS *e-file* Partners for Taxpayers
- IRS *e-file* Partners for Tax Professionals
- IRS *e-file* Partners for Financial Institutions/Employers
- IRS *e-file* Partners for Credit Card Payment Options

Safeguarding Taxpayer Data

The security of taxpayer accounts and personal information is a top priority for the IRS. Tax professionals must implement safeguards to protect taxpayer's data. It is not only the law, but it is good business practice, as it increases customer confidence and trust. Refer to Publication 4557, *Safeguarding Taxpayer Data, A Guide for Your Business*, which describes the various security provisions and rules that impact tax professionals. The document assists tax professionals in understanding their requirements for protecting the privacy and confidentiality of taxpayer data, and provides guidance on the implementing the necessary security controls within their business to satisfy these requirements. Publication 4557 can be accessed at ***http://www.irs.gov***.

PARTICIPATION STANDARDS & REQUIREMENTS

Participants will abide by the following standards and requirements, if applicable:

- The Participant was actively engaged in the electronic tax preparation and filing industry in 2006 and 2007.
- The Participant will offer their tax preparation and e-file services to the individual taxpayer. The IRS will not post advertisements offering both free tax preparation and free e-file on the IRS.gov Partners Page. Promotion on IRS.gov of free services, services that include both free tax preparation and free e-filing, is reserved for Free File Alliance members only. Visit ***www.freefilealliance.org*** to find out how to become a member of the Free File Alliance or visit ***www.irs.gov*** for more details on free file.
- The Participant will market, promote and offer e-file services through October 15, 2008. The Participant should use the key marketing messages, provided by the IRS, for the promotion of Filing Season and Post Filing Season electronic filing and place them on your web site.
- The Participant (Electronic Return Originator, Intermediate Service Provider, Software Developer, and Transmitter) must be in good standing with the IRS, comply with the e-file requirements stated in the IRS Revenue Procedure 2007–40 (announced in IR Bulletin 2007–26 dated June 25, 2007), current versions of Publications 1345, 1345A, 3112, and pass the annual Suitability and Participants Acceptance Testing (PATS) conducted by the IRS. You can find the IRS e-file technical publications on the IRS web site at ***http://www.irs.gov***.
- The Participant will comply with the privacy provisions of 26 U.S.C. § 7216 and U.S.C.§ 6103.
- The Participant will be required to prove and display third-party certifications for the privacy/security/authenticity of its online service. The Participant's web site should display the third-party certification and privacy seals. Participants must use software that will enable their web sites to state their privacy practices in a standard machine-readable format that can be retrieved automatically and interpreted easily by users.
- Participants will comply with the security provisions in applicable Department of Treasury/IRS rules including, but not limited to, 31 C.F.R. Part 10, IRS Rev. Proc. 2005–60, current versions of IRS Publications 1345, 1345A, and 3112, and 26 U.S.C. § 7216. In addition, Participants must comply with the Federal Trade Commission's Gramm-Leach-Bliley Act to protect the security of taxpayer information. Refer to Publication 4557, *Safeguarding Taxpayer Data, A Guide for Your Business*, for guidance on various security rules and provisions that impact tax professionals. The document can be accessed at ***http://www.irs.gov***.
- The Participant will offer their products and services to filers of the individual 1040 Series returns, including complex returns, balance due returns, Federal/State returns, and 1040EZ returns.
- The Participant will clearly disclose its customer service support options (including associated fees, if any) and privacy policy on the landing page of its web site. Participants must provide taxpayers with a business contact point by on-line form, email, mail, facsimile or telephone number which the Participant maintains and reviews.
- **The Participant is encouraged to offer the Spanish versions for online filing and/or downloadable software.** The Participant who offers Spanish versions for online filing and/or downloadable software will have customer service support to assist Hispanic taxpayers.
- The Participant will target v-coders and individuals eligible for EITC.
- The Participant will focus on reducing the number of errors on electronically prepared returns, including those returns claiming EITC.
- The Participant will offer a variety of e-file features including the Self-Select PIN, Electronic Payment Options, Federal/State e-file, Direct Deposit of Refunds, etc.
- The Participant will be permitted only **one (1)** hyperlink on the IRS *e-file* Partners Page per category:
  - IRS *e-file* Partners for Taxpayer
  - IRS *e-file* Partners for Tax Professionals
  - IRS *e-file* Partners for Financial Institutions/Employers
  - IRS *e-file* Partners for Electronic Payment Options
- The Participant will provide the IRS with a description (**not to exceed 200 characters including spaces**) for each hyperlink placed on the IRS *e-file* Partners Page. The hyperlink description may describe multiple offers/services.
- The Participant will not have a URL(s) containing the word "IRS."
- The Participant will be required to supply the IRS with a link to their web site in their application or **no less than ten (10) business days** before the site is expected to go live (start date of electronic filing). All sites must be examined before they can be posted on the IRS *e-file* Partners Page. The purpose

of the review is to ensure each Participant's web site complies with the standards and requirements set forth in this announcement.

- The Participant will adhere to the IRS *e-file* rule for registration of web sites which enables IRS to more quickly identify fraud schemes, including phishing. Failure to do so could result in suspension or expulsion from participation in IRS *e-file*. For more information, visit ***http://www.irs.gov/efile/index.html***.
- The Participant will adhere to industry best practices to ensure the taxpayer return information entrusted to them is secure and the privacy of such information is maintained. In any instance where a Participant contracts with a service provider to obtain technology services, it will adhere to this standard. To the extent multiple Participants rely on a single service provider for front or back office services (not ISP services), it is even more critical that such taxpayer security and privacy be maintained with respect to others who share these services.
- A Participant's web site will be functionally adequate and consistent with the Participant's offer in permitting a taxpayer to complete their return. Failure to comply may result in the Participant's removal from the Partners Page.
- Whenever taxpayers are requested or required to provide their SSN, it must be part of a secure session. Participants are not permitted to use SSNs as a requested field for registration purposes or for establishing a taxpayer account on-line.
- The Participant will display the IRS *e-file* logo on the landing page of its web site. **The e-file logo should be a click-through to the IRS e-file landing page *www.irs.gov/efile*.** If the e-file logo is displayed on other web pages in addition to the landing page of the Participant, the logo(s) should be a click-through to the IRS e-file landing page. The e-file logo and guidelines can be downloaded from ***http://www.irs.gov***.
- The Participant's web site will not contain inappropriate content. Participant web sites must meet the following criteria:
  - The site clearly relates to and complements existing information, products and services on IRS.gov.
  - The site contains relevant and useful content that will benefit our customers.
  - The site contains accurate and timely information.
  - The site provides information at no cost. The Participant will not link to sites whose primary purpose is to sell products or services (unless it is part of an approved agreement with IRS).
  - The site has an excellent overall quality and professional image.
  - The site is easy to navigate.
  - The site is a credible source for information. The site must be free of typos and errors so that it does not detract from the readability of the site.
  - The site does not exhibit hate, bias, or discrimination.
  - The site does not contain misleading or unsubstantiated claims or conflict with the mission of the IRS.
- The Participant must provide taxpayers a method to obtain the status of their tax return. Taxpayers can be directed to **"Where's My Tax Refund?"** located on the Homepage of the IRS web site at ***http://www.irs.gov***.
- The Participant will prominently display on the landing page of its web site the promotion of income tax preparation and electronic filing for individuals eligible for EITC.
- The Participant is encouraged to offer a monetary incentive (reduced return preparation and electronic filing costs) to attract taxpayers.
- The Participant will disclose limitations in the forms and schedules that are likely to be needed to support their offerings. The Participant should clearly display a listing of the forms and schedules that will be offered either visible or accessible from the Participant's landing page.
- The Participant will clearly disclose a listing of the States that their software supports either visible or accessible from the Participant's landing page.
- The Participant is permitted to offer commercial products and services consistent with obtaining the positive consent of the user as described in 26 U.S.C. 7616 before offering fee-based products and services not related to tax preparation.
- The Participant will include a feature in their tax preparation software that will "time out" the session after no changes are made for a period of time consistent with best practices approved by privacy seal certification programs.
- The Participant that learns of an inappropriate disclosure of a taxpayer's return information to an unauthorized Person must report the unauthorized disclosure to the IRS immediately but no later than five (5) hours after detection; and immediately shut down its program at the time of detection.
- The Participant will submit written notification (*e.g.*, email) to the IRS of changes, additions and deletions to URLs, link descriptions, etc.
- The Participant will submit Performance Reports to the IRS Point of covering Filing Season and post Filing Season activity. The reports will cover information such as e-file statistics, web site activity and anything else the IRS deems necessary. The IRS Point of Contact will provide written reporting instructions and requirements to accepted Participants.

PERFORMANCE STANDARDS

- The IRS will have the accepted Participant's hyperlink(s) available on the IRS web site for the start of electronic filing, subject to the participant's passing of the annual Suitability, PATS testing, and web site review. Hyperlinks will remain on the IRS *e-file* Partners Page through **October 15, 2008, or at the discretion of the IRS**.
- The IRS will randomize on a daily basis the offers of the Participants listed on the IRS *e-file* Partners Page.
- The IRS may establish a link from the IRS *e-file* Partners Page to the Free File web page and *vice versa*.
- The IRS will accept, if appropriate, the Participant's written request for changes/additions/deletions to a URL, link description, etc.
- The IRS will review the Participant's web site(s) at any time to ensure that participation requirements are met.

- The IRS will not endorse specific offerings or products, but will promote the IRS *e-file* Partners Page. A "Site Disclaimer" will be displayed upon exiting the IRS web site before the user enters the Participant's web site.

PARTICIPATION TERMS

The IRS Individual *e-file* Partnership Program is an annual program, and all prospective Participants, including returning Participants, must reapply each year following the guidelines in the Internal Revenue Bulletin announcement advertised on ***http://www.irs.gov***. If the IRS determines that the Participant is not meeting the "Participation Standards & Requirements," the IRS may terminate its partnership with the Participant and remove the participant's hyperlink(s) from the IRS *e-file* Partners Page.

- The Participant will notify the IRS immediately if it wishes to terminate its partnership with the IRS. The notification should be submitted through email to the IRS Point of Contact or sent to the Point of Contact's address indicated below in "IRS Point of Contact/Application Submission."

APPLICATION PROCESS

Applications should contain the following information, **if applicable**:

- Provide Primary and Secondary Points of Contact (name, title, address, cell/telephone number, fax number and email address) for discussion of your application and program participation.
- Identify the Applicant's secure web site.
- Identify the Applicant's tax preparation software and the States it will support.
- Identify the IRS forms and schedules that support your offering(s).
- Include the Applicant's Electronic Filer Identification Number(s) (EFIN) and/or Electronic Transmitter Identification Number (ETIN).
- Indicate if the Applicant will offer the Spanish versions for online filing and/or downloadable software. Describe customer service support for assisting Hispanic taxpayers.
- Identify the Applicant's hyperlink(s) and provide a short description **(not to exceed 200 characters including spaces)** of the services and products to be promoted on the IRS *e-file* Partners Page. In addition, the Applicant should provide the associated URL(s). **The URL(s) cannot contain the word "IRS."** Indicate the category for each hyperlink:

  - IRS *e-file* Partners for Taxpayers
  - IRS *e-file* Partners for Tax Professionals
  - IRS *e-file* Partners for Financial Institutions/Employers
  - IRS *e-file* Partners for Electronic Payment Options

- Identify the Applicant's third party administrators (*i.e.*, VeriSign, Thawte, Truste) that certify the privacy/security/authenticity of its online service and provide certification that the Applicant's current status is active and in good standing.
- Identify the Applicant's communication vehicle(s) (*i.e.*, web site, marketing/promotional products, etc.) to market and promote your products and services and IRS *e-file*. Describe the incentives, discounts, offers, benefits to taxpayers or other specific approaches to increase *e-file* volumes.
- Describe steps the Applicant will take to reach taxpayers that claim EITC. This can include marketing/promotional efforts, monetary incentives (reduced return preparation and electronic filing costs).
- Describe steps the Applicant will take to reduce errors on electronically filed returns, including those returns claiming EITC.
- Certify the Applicant's compliance with the privacy and disclosure provisions of 26 U.S.C. 7216 and 26 U.S.C. 6103.
- Certify the Applicant's compliance with the Federal Trade Commission's Gramm-Leach-Bliley (GLB) Act of 1999, Financial Privacy Rule and Safeguard Rules.

IRS POINT OF CONTACT/APPLICATION SUBMISSION

Applications to participate in the IRS Individual *e-file* Partnership Program should be submitted as a Word document through email at ****WIe-filepartners@irs.gov***. (Please make sure there is an asterisk (*) before the WI (Wage and Investment) when submitting an application.) An application may also be sent to:

Internal Revenue Service
5000 Ellin Road
Lanham, MD 20706
Attention: Karen Bradley C4–132
SE:W:CAR:SPEC:FO:IMS

If you wish to have a hyperlink(s) on the IRS *e-file* Partners Page for the start of electronic filing, your application must be submitted by December 13, 2007. If your application is received after the deadline, there is no guarantee that it will be accepted by the IRS.

Any questions regarding the development of applications, the submission of Performance Reports, or any other type of contact for this program should be directed to Karen Bradley at (202) 283–7034 or through email to ****WIe-filepartners@irs.gov***. Please make sure there is an asterisk (*) before the WI (Wage and Investment) for any type of email contact.

APPLICATION EVALUATION

All applications will be evaluated based on the required information provided to the IRS and the applicant's ability to fulfill their responsibilities. Prior year performance will also be considered when evaluating applications from returning partners.

ACCEPTANCE/DENIAL OF APPLICATION

If your application is accepted, you will receive written notification from the IRS. If your application is denied, you will receive written notification from the IRS with an explanation of the denial.

e-Help

If you have any questions related to e-products/electronic filing, you can

contact the e-Help Desk toll-free at **1–866–255–0654**. The e-Help desk assistors are ready to respond to non-account related questions and issues. You can also go to ***http://www.irs.gov*** where the IRS houses a variety of information which impacts the tax professional.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

T.D. 9361

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Corporate Reorganizations; Transfers of Assets or Stock Following a Reorganization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the effect of certain transfers of assets or stock on the continuing qualification of transactions as reorganizations under section 368(a). This document also contains final regulations that provide guidance on the continuity of business enterprise requirement and the definitions of "qualified group" and "party to a reorganization." These regulations affect corporations and their shareholders.

DATES: *Effective Date:* These regulations are effective October 25, 2007.

Applicability Date: For dates of applicability, see §§1.368–1(d)(4)(iv), 1.368–1(d)(5), 1.368–2(f), 1.368–2(j)(3)(iv), and 1.368–2(k)(3).

FOR FURTHER INFORMATION CONTACT: Mary W. Lyons, at (202) 622–7930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 18, 2004, the IRS and Treasury Department published a notice of proposed rulemaking (REG–130863–04, 2004–2 C.B. 538) in the **Federal Register** (69 FR 51209) proposing regulations that would provide guidance regarding the effect of certain transfers of assets or stock on the qualification of a transaction as a reorganization under section 368(a) (the proposed regulations). The proposed regulations also included amendments to the continuity of business enterprise (COBE) regulations under §1.368–1(d) and the definition of a "party to a reorganization" under §1.368–2(f). The proposed regulations replaced an earlier proposal, dated March 2, 2004 (REG–165579–02, 2004–1 C.B. 651) and published in the **Federal Register** (69 FR 9771), which was withdrawn. No public hearing regarding the proposed regulations was requested or held. However, a number of comments were received, the most significant of which are discussed in this preamble.

The theory underlying the tax-free treatment afforded reorganizations described in section 368 is that such transactions "effect only a readjustment of continuing interest in property under modified corporate forms." See §1.368–1(b). The continuity of interest and continuity of business enterprise requirements are expressions of this principle. Earlier cases also implemented this principle through a concept that later became known as the prohibition of "remote" continuity of interest. Commonly viewed as arising out of the Supreme Court decisions in *Groman v. Commissioner*, 302 U.S. 82 (1937), and *Helvering v. Bashford*, 302 U.S. 454 (1938), remote continuity of interest focuses on the link between the former target corporation (T) shareholders and the T business assets following the reorganization.

Since the Supreme Court's decisions in *Groman* and *Bashford*, it has been recognized that other transactions, including transactions involving the same level of "remoteness" as addressed in the *Groman* and *Bashford* decisions, adequately preserve the link between the former T shareholders and the T business assets and therefore constitute mere readjustments of continuing interests. Accordingly, legislative, regulatory, and administrative developments have provided significantly more flexibility regarding transfers of stock and assets following otherwise tax-free reorganizations where this link is adequately maintained. For example, Congress enacted section 368(a)(2)(D) to expressly allow a triangular reorganization by permitting a controlled subsidiary to use its parent's stock as consideration in a merger. Similarly, the term "party to a reorganization" was broadened to include the parent in such a case.

In addition, Congress enacted section 368(a)(2)(C), which provides that a transaction otherwise qualifying under section 368(a)(1)(A), (B), (C), or (G) (where the requirements of section 354(b) are met) is not disqualified where part or all of the acquired assets or stock is transferred to a corporation that is controlled (as defined in section 368(c)) by the acquiring corporation. Section 1.368–2(k), as in effect prior to these final regulations, expanded the scope of section 368(a)(2)(C) by permitting successive transfers of the acquired assets or stock to one or more corporations, provided that the transferee corporation was controlled in each transfer by the transferor corporation. Administratively, the IRS and Treasury Department have since interpreted section 368(a)(2)(C) and §1.368–2(k) as permissive rather than exclusive or restrictive, concluding that certain transfers not specifically described in either of those provisions did not disqualify the reorganization. See Rev. Rul. 2001–24, 2001–1 C.B. 1290, permitting the transfer of acquiring subsidiary stock to a controlled subsidiary following a reorganization described in section 368(a)(1)(A) by reason of (a)(2)(D), and Rev. Rul. 2002–85, 2002–2 C.B. 986, permitting the transfer of acquired assets to a controlled subsidiary following a reorganization described in section 368(a)(1)(D).

The current regulations do not contain separate rules addressing remote continuity because the IRS and Treasury Department believe that these issues are adequately addressed by the rules adopted to implement the continuity of business enterprise requirement. See T.D. 8760, 1998–1 C.B. 803 [63 FR 4174]. Similarly, the rules relating to the continuity of business enterprise requirement have been broadened over the years to permit transactions that adequately preserve the link

between the former T shareholders and the T business assets. Under §1.368–1(d), as in effect prior to these final regulations, the COBE requirement generally is satisfied as long as a member of the qualified group (or, in certain cases, a partnership) either continues T's historic business or uses a significant portion of T's historic business assets in a business. A *qualified group* is defined in §1.368–1(d)(4)(ii), as in effect prior to these final regulations, as one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of section 368(c) in at least one of the corporations, and stock meeting the requirements of section 368(c) in each of the corporations (other than the issuing corporation) is owned directly by one of the other corporations.

These final regulations continue the trend of broadening the rules regarding transfers of assets or stock following an otherwise tax-free reorganization where the transaction adequately preserves the link between the former T shareholders and the T business assets. Accordingly, the definition of a "qualified group" in §1.368–1(d)(4)(ii) and the rules regarding stock or asset transfers in §1.368–2(k) have been expanded. Conforming changes to §1.368–2(f), relating to the definition of "a party to a reorganization," also have been made.

A. *Continuity of Business Enterprise (COBE) Regulations*

Several commentators urged that the definition of "qualified group" under §1.368–1(d)(4)(ii) should not be restricted by the control requirement of section 368(c), but rather should be expanded to parallel the definition of an affiliated group under section 1504(a). The IRS and Treasury Department have declined to make this change, primarily because the section 368(c) definition of control is a major structural component underlying the statutory framework of the reorganization provisions. On the other hand, the IRS and Treasury Department have concluded that it is consistent with reorganization policy to expand the definition of a qualified group. Specifically, §1.368–1(d)(4)(ii), as revised by this Treasury decision, permits qualified group members to aggregate their direct stock ownership of a corporation in determining whether they own the requisite section 368(c) control in such corporation (provided that the issuing corporation owns directly stock meeting such control requirement in at least one other corporation). This aggregation concept is similar to the one found in section 1504(a). The IRS and Treasury Department believe that aggregating stock ownership within the qualified group adequately preserves the link between the former T shareholders and the T business assets while further facilitating the post-acquisition relocation of assets and stock as necessary within the group.

Finally, as discussed in section B.3. of this preamble, and in response to comments, the COBE regulations have been expanded to provide that if members of the qualified group own interests in a partnership that meets requirements equivalent to the control definition in section 368(c), any stock owned by such partnership is treated as owned by members of the qualified group. Thus, for example, following a reorganization under section 368(a)(1)(B), T remains a member of the qualified group upon a transfer of the T stock to a partnership in which members of the qualified group own all the interests. See section B.3. of this preamble. Similarly, a wholly owned subsidiary of a partnership in which members of the qualified group own all the interests will be a member of the qualified group. Accordingly, following a reorganization under section 368(a)(1)(A), the acquiring corporation may transfer the T assets to the subsidiary (either directly or through the partnership) without violating the COBE requirement.

B. *Section 1.368–2(k)*

As provided in §1.368–1(a), a transaction must be evaluated under all relevant provisions of law, including the step transaction doctrine, in determining whether it qualifies as a reorganization under section 368(a). Section 1.368–2 provides guidance regarding whether a transaction satisfies the explicit statutory requirements of a particular reorganization. Section 1.368–2(k) generally provides that a transaction otherwise qualifying as a reorganization will not be disqualified as a result of certain subsequent transfers of assets or stock. The fact that a subsequent transfer of assets or stock is not described in §1.368–2(k) does not necessarily preclude reorganization qualification, but the overall transaction would then be subject to analysis under the step transaction doctrine.

These final regulations adopt the rules of the proposed regulations regarding subsequent transfers of assets or stock with certain modifications. Section 1.368–2(k), as revised by this Treasury decision, generally provides that a transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the COBE requirement is satisfied and the transfer(s) qualify as "distributions" or "other transfers" (as described in §1.368–2(k)(1), and as discussed in section B.1. and B.2., respectively, of this preamble).

1. *Distributions*

Proposed §1.368–2(k) would permit the acquiring corporation to distribute to certain shareholders part or all of the stock or assets acquired in a transaction otherwise qualifying as a reorganization without affecting its characterization as such. The proposed regulations would generally permit distributions to certain shareholders provided that no distributee receives "substantially all" of the acquired assets, including the assets of a corporation whose stock is acquired in the reorganization, or stock constituting control of the acquired corporation. This limitation reflected the concern that such a transaction might be more properly characterized as a direct acquisition by the distributee. For example, Rev. Rul. 67–274, 1967–2 C.B. 141, held that an acquisition of T stock in a purported reorganization under section 368(a)(1)(B) followed by a prearranged liquidation of T is treated as a reorganization under section 368(a)(1)(C); Rev. Rul. 72–405, 1972–2 C.B. 217, held that an acquisition of T in a forward triangular merger followed by a prearranged liquidation of the acquiring corporation is treated as a reorganization under section 368(a)(1)(C); and Rev. Rul. 2004–83, 2004–2 C.B. 157, held that a purchase of T stock from the common shareholder followed by a prearranged liquida-

tion of T is treated as a reorganization under section 368(a)(1)(D).

Commentators raised an administrative concern that the parameters of the "substantially all" standard are less than certain, at least under case law, and, thus, requested that a safe harbor test be adopted in the final regulations. The IRS and Treasury Department believe that this is a valid concern. Accordingly, these final regulations have adopted a different approach than the "substantially all" standard of the proposed regulations. The new approach in these final regulations focuses on whether the distribution consists of an amount of assets (disregarding any assets held by the acquiring corporation, or the merged corporation in the case of a reorganization under section 368(a)(1)(A) by reason of (a)(2)(E), prior to the transaction) that would result in the distributing corporation being treated as liquidated for Federal income tax purposes.

The IRS and Treasury Department believe that this approach will be easier for taxpayers to apply and the government to administer than the "substantially all" standard in the proposed regulations. In addition, this approach more fully preserves the analysis and conclusions set forth in Rev. Rul. 67–274, Rev. Rul. 72–405, and Rev. Rul. 2004–83, in the context of Congress having required the target corporation to liquidate in all asset reorganizations. Finally, this approach more consistently applies the principles of section 368(a)(2)(C) (which allows for transfers of all of the acquired assets or stock) to post-acquisition distributions.

Specifically, these final regulations provide that a transaction otherwise qualifying as a reorganization will not be disqualified or recharacterized as a result of one or more distributions of assets, stock of the acquired corporation, or both, provided the COBE requirement is satisfied and the distributions do not result in a liquidation of the distributing corporation for Federal income tax purposes (disregarding, for this purpose, assets held by the acquiring corporation, or the merged corporation in the case of a reorganization under section 368(a)(1)(A) by reason of (a)(2)(E), prior to the transaction). Additionally, in the case of distributions of stock of the acquired corporation, these final regulations only protect the transaction from disqualification or recharacterization if the distributions consist of less than all of the stock of the acquired corporation that was acquired in the transaction and do not cause the acquired corporation to cease to be a member of the qualified group.

These final regulations also clarify that certain indirect distributions of assets are treated under §1.368–2(k) in the same manner as a direct distribution of those assets. For example, such an indirect distribution of assets can occur where, following a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(A), the acquiring corporation transfers a portion of the T assets to a partnership (or a corporation) in exchange for an interest in the transferee partnership (or stock in the transferee corporation) in an "other transfer" described in §1.368–2(k)(1)(ii), and then distributes that partnership interest (or stock) to a shareholder.

Finally, the IRS and Treasury Department believe that distributions of assets under these final regulations that involve the assumption of liabilities are distinguishable from the transaction analyzed in Rev. Rul. 70–107, 1970–1 C.B. 78. That ruling considered a transaction in which the acquiring corporation acquired all of the target corporation's assets in exchange for voting stock of the acquiring corporation's parent. In the transaction, the target corporation's liabilities were assumed in part by the acquiring corporation and in part by the acquiring corporation's parent. The ruling holds that the parent corporation's direct assumption of some of the target corporation's liabilities violates the solely for voting stock requirement of section 368(a)(1)(C). These final regulations do not implicate the fact pattern addressed in Rev. Rul. 70–107.

2. *Other transfers*

Proposed §1.368–2(k) would provide, in part, that a transaction otherwise qualifying as a reorganization under section 368(a) would not be disqualified if any assets or stock of a party to the reorganization, other than the stock of the issuing corporation, is subsequently transferred to a member of the qualified group. Commentators asked that the reference to transfers of stock of the issuing corporation be removed, stating that the effect, if any, of a transfer of the stock of the issuing corporation is adequately addressed by the continuity of interest rules under §1.368–1(e). The IRS and Treasury Department agree. In response to this comment (and comments regarding the interaction with the definition of a party to the reorganization in §1.368–2(f)), this provision has been revised to refer to the assets or stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be.

Accordingly, these final regulations provide that a transaction otherwise qualifying as a reorganization will not be disqualified or recharacterized as a result of one or more transfers (that do not constitute distributions) of assets or stock, or both, of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided the COBE requirement is satisfied, and the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, does not terminate its corporate existence in connection with the transfer(s). In the case of transfers of stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, these final regulations only protect the transaction from disqualification or recharacterization if the transfers do not cause such corporation to cease to be a member of the qualified group.

3. *Transfers of stock to partnerships*

Example 3 of former §1.368–2(k), issued January 28, 1998 (63 FR 4174), involved a transfer of stock of the acquired corporation to a partnership. In the example, P acquired all the stock of T solely in exchange for P stock in a transaction that otherwise qualified as a reorganization under section 368(a)(1)(B). Immediately thereafter, P transferred the T stock to members of its qualified group, who then transferred the T stock to a partnership all of the interests in which were owned by such members. The example concludes that because the transfer of T stock to the partnership is not described in §1.368–2(k), the characterization of the transaction must be determined under relevant provisions of law, including the step transaction doctrine. The example further concludes that the transaction fails to meet the control requirement

of a reorganization described in section 368(a)(1)(B) because immediately after the transaction the acquiring corporation does not have control of T. The preamble to the proposed regulations indicated that the IRS and Treasury Department were reexamining the conclusion set forth in *Example 3* and requested comments in this regard. Consequently, *Example 3* was not included in the proposed regulations. Comments were received and considered in the course of studying this issue.

After further examination, the IRS and Treasury Department have concluded that transfers of stock of a corporation to a controlled partnership (that is, one in which members of the qualified group own interests meeting requirements equivalent to section 368(c)) adequately preserve the link between the former T shareholders and the T business assets. This section 368(c) equivalent control standard is applied to transfers of stock to a partnership in order to protect the section 368(c) control requirement applicable to triangular and stock acquisition reorganizations. Accordingly, these final regulations reverse the conclusion reached in *Example 3* of former §1.368–2(k).

To accommodate these policy considerations, the final regulations permit both distributions of stock of the acquired corporation and other transfers of stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided the transfer of stock does not cause the transferred corporation to cease to be a member of the COBE qualified group. To that end, as described in section A. of this preamble, the COBE regulations have been expanded to provide that if members of the qualified group own interests in a partnership that meet requirements equivalent to the control definition in section 368(c), any stock owned by such partnership is attributed to and treated as owned by members of the qualified group. Accordingly, this full stock attribution rule treats partnerships in a manner similar to members of the COBE qualified group.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these final regulations is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

Availability of IRS Documents

IRS revenue rulings, procedures, and notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.368–1 is amended as follows:

1. Paragraph (d)(4)(ii) is revised.
2. Paragraph (d)(4)(iii)(D) is added.
3. Paragraph (d)(4)(iv) is revised.
4. Paragraph (d)(5) introductory text is revised.
5. In paragraph (d)(5), *Examples 7* through *12* are redesignated as *Examples 8* through *13*, respectively, and new *Examples 7*, *14*, and *15* are added.
6. In paragraph (d)(5), the first sentences of paragraph (i) in redesignated *Examples 9*, *10*, and *12* are revised.

The revisions and additions read as follows:

§1.368–1 Purpose and scope of exception of reorganization exchanges.

* * * * *

(d) * * *

(4) * * *

(ii) *Qualified group.* A qualified group is one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of section 368(c) in at least one other corporation, and stock meeting the requirements of section 368(c) in each of the corporations (except the issuing corporation) is owned directly (or indirectly as provided in paragraph (d)(4)(iii)(D) of this section) by one or more of the other corporations.

(iii) * * *

(D) *Stock attributed from certain partnerships.* Solely for purposes of paragraph (d)(4)(ii) of this section, if members of the qualified group own interests in a partnership meeting requirements equivalent to section 368(c) (a section 368(c) controlled partnership), any stock owned by the section 368(c) controlled partnership shall be treated as owned by members of the qualified group. Solely for purposes of determining whether a lower-tier partnership is a section 368(c) controlled partnership, any interest in a lower-tier partnership that is owned by a section 368(c) controlled partnership shall be treated as owned by members of the qualified group.

(iv) *Effective/applicability dates.* Paragraphs (d)(4)(i) and (d)(4)(iii) (other than paragraph (d)(4)(iii)(D)) of this section apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraphs (d)(4)(ii) and (d)(4)(iii)(D) of this section apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

(5) *Examples.* The following examples illustrate this paragraph (d). All the corporations have only one class of stock outstanding. The preceding sentence and

paragraph (d)(5) *Example 6* and *Example 8* through *Example 13* apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraph (d)(5) *Example 7*, *Example 14*, and *Example 15* apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that. The examples read as follows:

* * * * *

Example 7. Transfers of acquired stock to members of the qualified group — continuity of business enterprise satisfied. (i) *Facts.* The facts are the same as *Example 6*, except that, instead of P acquiring the assets of T, HC acquires all of the outstanding stock of T in exchange solely for stock of P. In addition, as part of the plan of reorganization, HC transfers 10 percent of the stock of T to each of subsidiaries S–1 through S–10. T will continue to operate an auto parts distributorship. Without regard to whether the transaction satisfies the COBE requirement, the transaction qualifies as a triangular B reorganization (as defined in §1.358–6(b)(2)(iv)).

(ii) *Continuity of business enterprise.* Under paragraph (d)(4)(i) of this section, P is treated as holding the assets and conducting the business of T because T is a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is satisfied.

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Example 9. * * * (i) *Facts.* The facts are the same as *Example 8*, except that S–3 transfers the historic T business to PRS in exchange for a 1 percent interest in PRS.

(ii) * * *

Example 10. * * * (i) *Facts.* The facts are the same as *Example 8*, except that S–3 transfers the historic T business to PRS in exchange for a 33$^1/_3$-percent interest in PRS, and no member of P's qualified group performs active and substantial management functions for the ski boot business operated in PRS.

* * * * *

Example 12. * * * (i) *Facts.* The facts are the same as *Example 11*, except that S–1 transfers all the T assets to PRS, and P and X each transfer cash to PRS in exchange for partnership interests. * * *

* * * * *

Example 14. Transfer of acquired stock to a partnership — continuity of business enterprise satisfied. (i) *Facts.* Pursuant to a plan of reorganization, the T shareholders transfer all of their T stock to a subsidiary of P, S–1, solely in exchange for P stock. In addition, as part of the plan of reorganization, S–1 transfers the T stock to its subsidiary, S–2, and S–2 transfers the T stock to its subsidiary, S–3. S–2 and S–3 form a new partnership, PRS. Immediately thereafter, S–3 transfers all of the T stock to PRS in exchange for an 80 percent interest in PRS, and S–2 transfers cash to PRS in exchange for a 20 percent interest in PRS.

(ii) *Continuity of business enterprise.* Members of the qualified group, in the aggregate, own all of the interests in PRS. Because these interests in PRS meet requirements equivalent to section 368(c), under paragraph (d)(4)(iii)(D) of this section, the T stock owned by PRS is treated as owned by members of the qualified group. P is treated as holding all of the businesses and assets of T because T is a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is satisfied because P is treated as continuing T's business.

Example 15. Transfer of acquired stock to a partnership — continuity of business enterprise not satisfied. (i) *Facts.* The facts are the same as in *Example 14*, except that S–3 and U, an unrelated corporation, form a new partnership, PRS, and, immediately thereafter, S–3 transfers all of the T stock to PRS in exchange for a 50 percent interest in PRS, and U transfers cash to PRS in exchange for a 50 percent interest in PRS.

(ii) *Continuity of business enterprise.* Members of the qualified group, in the aggregate, own 50 percent of the interests in PRS. Because these interests in PRS do not meet requirements equivalent to section 368(c), the T stock owned by PRS is not treated as owned by members of the qualified group under paragraph (d)(4)(iii)(D) of this section. P is not treated as holding all of the businesses and assets of T because T has ceased to be a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is not satisfied because P is not treated as continuing T's business or using T's historic business assets in a business.

* * * * *

Par. 3. Section 1.368–2 is amended by:

1. Adding three sentences at the end of paragraph (f).

2. Revising paragraphs (j)(3)(ii) and (iv).

3. Removing the first sentence of paragraph (j)(3)(iii) and adding two new sentences at the beginning of the paragraph.

4. Revising paragraph (k).

The additions and the revisions read as follows:

§1.368–2 Definition of terms.

* * * * *

(f) * * * If a transaction otherwise qualifies as a reorganization under section 368(a)(1)(B) or as a reverse triangular merger (as defined in §1.358–6(b)(2)(iii)), the target corporation (in the case of a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(B)) or the surviving corporation (in the case of a transaction that otherwise qualifies as a reverse triangular merger) remains a party to the reorganization even though its stock or assets are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a forward triangular merger (as defined in §1.358–6(b)(2)(i)), a triangular B reorganization (as defined in §1.358–6(b)(2)(iv)), a triangular C reorganization (as defined in §1.358–6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), the acquiring corporation remains a party to the reorganization even though its stock is transferred in a transaction described in paragraph (k) of this section. The two preceding sentences apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

* * * * *

(j) * * *

(3) * * *

(ii) Except as provided in paragraph (k) of this section, the controlling corporation must control the surviving corporation immediately after the transaction.

(iii) After the transaction, the surviving corporation must hold substantially all of its own properties and substantially all of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction). The surviving corporation may transfer such properties as provided in paragraph (k) of this section. * * *

(iv) Paragraph (j)(3)(ii) and the first two sentences of paragraph (j)(3)(iii) of this section apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times thereafter. The remainder of paragraph (j)(3)(iii) of this section applies to transactions occurring after January 28, 1998, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times after that.

* * * * *

(k) *Certain transfers of assets or stock in reorganizations*—(1) *General rule.* A transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as

a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the requirements of §1.368–1(d) are satisfied and the transfer(s) are described in either paragraph (k)(1)(i) or (k)(1)(ii) of this section.

(i) *Distributions.* One or more distributions to shareholders (including distribution(s) that involve the assumption of liabilities) are described in this paragraph (k)(1)(i) if—

(A) The property distributed consists of—

(*1*) Assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, or an interest in an entity received in exchange for such assets in a transfer described in paragraph (k)(1)(ii) of this section;

(*2*) Stock of the acquired corporation provided that such distribution(s) of stock do not cause the acquired corporation to cease to be a member of the qualified group (as defined in §1.368–1(d)(4)(ii)); or

(*3*) A combination thereof; and

(B) The aggregate of such distributions does not consist of—

(*1*) An amount of assets of the acquired corporation, the acquiring corporation (disregarding assets held prior to the potential reorganization), or the surviving corporation (disregarding assets of the merged corporation), as the case may be, that would result in a liquidation of such corporation for Federal income tax purposes; or

(*2*) All of the stock of the acquired corporation that was acquired in the transaction.

(ii) *Other Transfers.* One or more other transfers are described in this paragraph (k)(1)(ii) if—

(A) The transfer(s) are not described in paragraph (k)(1)(i) of this section;

(B) The property transferred consists of—

(*1*) Part or all of the assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be;

(*2*) Part or all of the stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided that such transfer(s) of stock do not cause such corporation to cease to be a member of the qualified group (as defined in §1.368–1(d)(4)(ii)); or

(*3*) A combination thereof; and

(C) The acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, does not terminate its corporate existence in connection with the transfer(s).

(2) *Examples.* The following examples illustrate the application of this paragraph (k). Except as otherwise noted, P is the issuing corporation, and T is an unrelated target corporation. All corporations have only one class of stock outstanding. T operates a bakery that supplies delectable pastries and cookies to local retail stores. The acquiring corporate group produces a variety of baked goods for nationwide distribution. Except as otherwise noted, P owns all of the stock of S–1 and 80 percent of the stock of S–4, S–1 owns 80 percent of the stock of S–2 and 50 percent of the stock of S–5, S–2 owns 80 percent of the stock of S–3, and S–4 owns the remaining 50 percent of the stock of S–5. The examples are as follows:

Example 1. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(C). (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S–1 solely in exchange for P stock, which T distributes to its shareholders, and S–1's assumption of T's liabilities. In addition, pursuant to the plan, S–1 transfers all of the T assets to S–2, and S–2 transfers all of the T assets to S–3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the successive transfers of all of the T assets to S–2 and from S–2 to S–3 because the transfers are not distributions described in paragraph (k)(1)(i) of this section, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368–1(d).

Example 2. Distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S–1 solely in exchange for P stock, which T distributes to its shareholders, and S–1's assumption of T's liabilities. In addition, pursuant to the plan, S–1 distributes half of the T assets to P, and P assumes half of the T liabilities.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the distribution of half of the T assets from S–1 to P, or P's assumption of half of the T liabilities from S–1, because the distribution consists of assets of the acquiring corporation, the distribution does not consist of an amount of S–1's assets that would result in a liquidation of S–1 for Federal income tax purposes (disregarding S–1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of §1.368–1(d).

Example 3. Indirect distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) *Facts.* The facts are the same as *Example 2*, except that, pursuant to the plan, S–1 contributes half of the T assets to newly formed S–6, S–6 assumes half of the T liabilities, and S–1 distributes all of the S–6 stock to P.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the transfer of half of the T assets to S–6 and the distribution of the S–6 stock to P because the transfer of half of the T assets to S–6 is described in paragraph (k)(1)(ii) of this section, the distribution of the S–6 stock to P is an indirect distribution of assets of the acquiring corporation, the distribution does not consist of an amount of S–1's assets that would result in a liquidation of S–1 for Federal income tax purposes (disregarding S–1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of §1.368–1(d).

Example 4. Distribution of acquired stock to a controlled partnership after a reorganization under section 368(a)(1)(B). (i) *Facts.* P owns 80 percent of the stock of S–1, and an 80-percent interest in PRS, a partnership. S–4 owns the remaining 20-percent interest in PRS. PRS owns the remaining 20 percent of the stock of S–1. Pursuant to a plan of reorganization, the T shareholders transfer all of their T stock to S–1 solely in exchange for P stock. In addition, pursuant to the plan, S–1 distributes 90 percent of the T stock to PRS in redemption of 5 percent of the stock of S–1 owned by PRS.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of 90 percent of the T stock from S–1 to PRS because the distribution consists of less than all of the stock of the acquired corporation that was acquired in the transaction, the distribution does not cause T to cease to be a member of the qualified group (as defined in §1.368–1(d)(4)(ii)), and the transaction satisfies the requirements of §1.368–1(d).

Example 5. Transfer of acquired stock to a noncontrolled partnership. (i) *Facts.* Pursuant to a plan, the T shareholders transfer all of their T stock to S–1 solely in exchange for P stock. In addition, as part of the plan, T distributes half of its assets to S–1, S–1 assumes half of the T liabilities, and S–1 transfers the T stock to S–2. S–2 and U, an unrelated corporation, form a new partnership, PRS. Immediately thereafter, S–2 transfers all of the T stock to PRS in exchange for a 50 percent interest in PRS, and U transfers cash to PRS in exchange for a 50 percent interest in PRS.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of half of the T assets from T to S–1, or S–1's assumption of half of the T liabilities from T, because the distribution consists of assets of the acquired corporation, the distribution does not consist of an amount of T's assets that would result in a liquidation of T for Federal income tax purposes, and the transaction satisfies the requirements of §1.368–1(d). Further, this paragraph (k) describes the transfer of the acquired stock from S–1 to S–2, but does not de-

scribe the transfer of the acquired stock from S–2 to PRS because such transfer causes T to cease to be a member of the qualified group (as defined in §1.368–1(d)(4)(ii)). Therefore, the characterization of this transaction must be determined under the relevant provisions of law, including the step transaction doctrine. See §1.368–1(a). The transaction fails to meet the control requirement of a reorganization described in section 368(a)(1)(B) because immediately after the acquisition of the T stock, the acquiring corporation does not have control of T.

Example 6. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(D). (i) *Facts.* P owns all of the stock of T. Pursuant to a plan of reorganization, T transfers all of its assets to S–1 solely in exchange for S–1 stock, which T distributes to P, and S–1's assumption of T's liabilities. In addition, pursuant to the plan, S–1 transfers all of the T assets to S–2, and S–2 transfers all of the T assets to S–3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(D), is not disqualified by the successive transfers of all the T assets from S–1 to S–2 and from S–2 to S–3 because the transfers are not distributions described in paragraph (k)(1)(i) of this section, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368–1(d).

Example 7. Transfer of stock of the acquiring corporation to a member of the qualified group after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). (i) *Facts.* Pursuant to a plan of reorganization, S–1 acquires all of the T assets in the merger of T into S–1. In the merger, the T shareholders receive solely P stock. Also, pursuant to the plan, P transfers all of the S–1 stock to S–4.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of all of the S–1 stock to S–4 because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the stock of the acquiring corporation, the transfer does not cause S–1 to cease to be a member of the qualified group (as defined in §1.368–1(d)(4)(ii)), the acquiring corporation does not terminate its corporate existence in connection with the transfer, and the transaction satisfies the requirements of §1.368–1(d).

Example 8. Transfer of acquired assets to a partnership after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). (i) *Facts.* Pursuant to a plan of reorganization, S–1 acquires all of the T assets in the merger of T into S–1. In the merger, the T shareholders receive solely P stock. In addition, pursuant to the plan, S–1 transfers all of the T assets to PRS, a partnership in which S–1 owns a 33⅓-percent interest. PRS continues T's historic business. S–1 does not perform active and substantial management functions as a partner with respect to PRS' business.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of T assets from S–1 to PRS because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368–1(d).

Example 9. Sale of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) *Facts.* Pursuant to a plan of reorganization, T transfers all of its assets to S–1 in exchange for P stock, which T distributes to its shareholders, and S–1's assumption of T's liabilities. In addition, pursuant to the plan, S–1 sells all of the T assets to S–5 for cash equal to the fair market value of those assets.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the sale of all of the T assets from S–1 to S–5 because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368–1(d).

(3) *Effective/applicability date.* This paragraph (k) applies to transactions occurring on or after October 25, 2007, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved October 16, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

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Section 6404.—Abatements

Ct. D. 2084

SUPREME COURT OF THE UNITED STATES

No. 06–376 (2007)

HINCK v. UNITED STATES

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

May 21, 2007

Syllabus

A 1986 amendment to the Internal Revenue Code permits the Treasury Secretary to abate interest that accrues on unpaid federal income taxes if the interest assessment is attributable to Internal Revenue Service (IRS) error or delay. 26 U.S.C. Sec. 6404(e)(1). Subsequently the federal courts uniformly held that the Secretary's decision not to abate was not subject to judicial review. In 1996, Congress added what is now Sec. 6404(h), which states that the Tax Court has "jurisdiction over any action brought by a taxpayer who meets the requirements referred to in section 7430(c)(4)(A)(ii) to determine whether the Secretary's failure to abate . . . was an abuse of discretion, and may order an abatement, if such action is brought within 180 days after the date of the mailing of the Secretary's final determination not to abate. . . ." Sec. 6404(h)(1). Section 7430(c)(4)(A)(ii) in turn incorporates 28 U.S.C. Sec. 2412(d)(2)(B), which refers to individuals with a net worth not exceeding $2 million and businesses with a net worth not exceeding $7 million. The IRS denied petitioner Hincks' request for abatement of interest assessed in 1999 for the period March 21, 1989, to April 1, 1993. The Hincks then filed suit in the Court of Federal Claims seeking review of the refusal to abate. The court granted the Government's motion to dismiss, and the Federal Circuit affirmed, holding that Sec. 6404(h) vests exclusive jurisdiction to review interest abatement claims in the Tax Court.

Held: the Tax Court provides the exclusive forum for judicial review of a failure to abate interest under Sec. 6404(e)(1). This Court's analysis is governed by the well-established principle that, in most contexts, "'a precisely drawn, detailed statute pre-empts more general remedies,'" *EC Term of Years Trust v. United States*, 550 U.S. ___, ___; it is also guided by the recognition that when Congress enacts a specific remedy when none was

previously recognized, or when previous remedies were "problematic," the remedy provided is generally regarded as exclusive, *Block v. North Dakota ex rel. Board of Univ. and School Lands,* 461 U.S. 273, 285. Section 6404(h) fits the bill on both counts. In a single sentence, it provides a forum for adjudication, a limited class of potential plaintiffs, a statute of limitations, a standard of review, and authorization for judicial relief; it was also enacted against a backdrop of decisions uniformly rejecting the possibility of any review of the Secretary's Sec. 6404(e)(1) determinations. Though Congress failed explicitly to define the Tax Court's jurisdiction as exclusive, it is quite plain that the terms of Sec. 6404(h) — a "precisely drawn, detailed statute" filling a perceived hole in the law — control all requests for review of Sec. 6404(e)(1) decisions, including the forum for adjudication. The Hincks correctly argue that Congress's provision of an abuse of discretion standard removed one of the obstacles courts had held foreclosed judicial review of such determinations, but Congress did not simply supply this single missing ingredient in enacting Sec. 6404(h). Rather, it set out a carefully circumscribed, time-limited, plaintiff-specific provision, which also precisely defined the appropriate forum. This Court will not isolate one feature of this statute and use it to permit taxpayers to circumvent the other limiting features in the *same* statute, such as a shorter statute of limitations than in general refund suits or a net-worth ceiling for plaintiffs eligible to bring suit. Taxpayers could "effortlessly evade" these specific limitations by bringing interest abatement claims as tax refund actions in the district courts or the Court of Federal Claims, disaggregating a statute Congress plainly envisioned as a package deal. *EC Term of Years Trust, supra,* at ___. Equally unavailing are the Hincks' contentions that reading Sec. 6404(h) to vest exclusive jurisdiction in the Tax Court impliedly repeals the pre-existing jurisdiction of the district courts and Court of Federal Claims, runs contrary to the structure of tax controversy jurisdiction, and would lead to the "unreasonable" result that taxpayers with net worths exceeding the specified ceilings would be foreclosed from seeking judicial review of Sec. 6404(e)(1) refusals to abate. Pp. 6–9.

446 F.3d 1307 affirmed.

ROBERTS, C.J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 06–376 (2007)

HINCK v. UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

May 21, 2007

CHIEF JUSTICE ROBERTS delivered the opinion of the Court.

Bad things happen if you fail to pay federal income taxes when due. One of them is that interest accrues on the unpaid amount. Sometimes it takes a while for the Internal Revenue Service (IRS) to determine that taxes should have been paid that were not. Section 6404(e)(1) of the Internal Revenue Code permits the Secretary of the Treasury to abate interest—to forgive it, partially or in whole—if the assessment of interest on a deficiency is attributable to unreasonable error or delay on the part of the IRS. Section 6404(h) allows for judicial review of the Secretary's decision not to grant such relief. The question presented in this case is whether this review may be obtained only in the Tax Court, or may also be secured in the district courts and the Court of Federal Claims. We hold that the Tax Court provides the exclusive forum for judicial review of a refusal to abate interest under Sec. 6404(e)(1), and affirm.

I

The Internal Revenue Code provides that if any amount of assessed federal income tax is not paid "on or before the last date prescribed for payment," interest "shall be paid for the period from such last date to the date paid." 26 U.S.C. Sec. 6601(a). Section 6404 of the Code authorizes the Secretary of the Treasury to abate any tax or related liability in certain circumstances. As part of the Tax Reform Act of 1986, Congress amended Sec. 6404 to add subsection (e(1), which, as enacted, provided in pertinent part:

> "In the case of any assessment of interest on . . . any deficiency attributable in whole or in part to any error or delay by an officer or employee of the Internal Revenue Service (acting in his official capacity) in performing a ministerial act . . . the Secretary may abate the assessment of all or any part of such interest for any period." 26 U.S.C. Sec. 6404(e)(1) (1994 ed.).

In the years following passage of Sec. 6404(e)(1), the federal courts uniformly held that the Secretary's decision not to grant an abatement was not subject to judicial review. See, *e.g., Argabright v. United States*, 35 F.3d 472, 476 (CA9 1994); *Selman v. United States*, 941 F.2d 1060, 1064 (CA10 1991); *Horton Homes, Inc. v. United States*, 936 F.2d 548, 554 (CA11 1991); see also *Bax v. Commissioner*, 13 F.3d 54, 58 (CA2 1993). These decisions recognized that Sec. 6404(e)(1) gave the Secretary complete discretion to determine whether to abate interest, "neither indicat[ing] that such authority should be used universally nor provid[ing] any basis for distinguishing between the instances in which abatement should and should not be granted." *Selman, supra*, at 1063. Any decision by the Secretary was accordingly "committed to agency discretion by law" under the Administrative Procedure Act, 5 U.S.C. Sec. 701(a)(2), and thereby insulated from judicial review. See, *e.g., Webster v. Doe*, 486 U.S. 592, 599 (1988); *Heckler v. Chaney*, 470 U.S. 821, 830 (1985).

In 1996, as part of the Taxpayer Bill of Rights 2, Congress again amended Sec. 6404, adding what is now subsection (h). As relevant, that provision states:

> "Review of denial of request for abatement of interest. — "1) In general.—The Tax Court shall have jurisdiction over any action brought by a taxpayer who meets the requirements referred to in section 7430(c)(4)(A)(ii) to determine whether the Secretary's failure to abate interest under this section was an abuse of discretion, and may order an abatement, if such action is brought within 180 days after the date of the mailing of the Secretary's final determination not to abate such interest." 26 U.S.C. Sec. 6404(h)(1) (2000 ed., Supp. IV).

Section 7430(c)(4)(A)(ii) in turn incorporates 28 U.S.C. Sec. 2412(d)(2)(B),

which refers to individuals with a net worth not exceeding $2 million and businesses with a net worth not exceeding $7 million. Congress made subsection (h) effective for all requests for abatement submitted to the IRS after July 30, 1996, regardless of the tax year involved. Sec. 302(b), 110 Stat.1458.[1]

II

In 1986, petitioner John Hinck was a limited partner in an entity called Agri-Cal Venture Associates (ACVA). Along with his wife, petitioner Pamela Hinck, Hinck filed a joint return for 1986 reporting his share of losses from the partnership. The IRS later examined the tax returns for ACVA and proposed adjustments to deductions that the partnership had claimed for 1984, 1985, and 1986. In 1990, the IRS issued a final notice regarding the partnership's returns, disallowing tens of millions of dollars of deductions. While the partnership sought administrative review of this decision, the Hincks, in May 1996, made an advance remittance of $93,890 to the IRS toward any personal deficiency that might result from a final adjustment of ACVA's returns. In March, 1999, the Hincks reached a settlement with the IRS concerning the ACVA partnership adjustments, to the extent they affected the Hincks' return. Shortly thereafter, as a result of the adjustments, the IRS imposed additional liability against the Hincks: $16,409 in tax and $21,669.22 in interest. The IRS applied the Hincks' advance remittance to this amount and refunded them the balance of $55,811.78.

The Hincks filed a claim with the IRS contending that, because of IRS errors and delays, the interest assessed against them for the period from March 21, 1989, to April 1, 1993, should be abated under Sec. 6404(e)(1). The IRS denied the request. The Hincks then filed suit in the United States Court of Federal Claims seeking review of the refusal to abate. That court granted the Government's motion to dismiss, 64 Fed. Cl. 71, 81 (2005), and the United States Court of Appeals for the Federal Circuit affirmed, 446 F.3d 1307, 1313–1314 (2006), holding that Sec. 6404(h) vests exclusive jurisdiction to review interest abatement claims under Sec. 6404(e)(1) in the Tax Court. Because this decision conflicted with the Fifth Circuit's decision in *Beall v. United States*, 336 F.3d 419, 430 (2003) (holding that Sec. 6404(h) grants concurrent, rather than exclusive, jurisdiction to the Tax Court), we granted certiorari, 549 U.S. ___ (2007).

III

Our analysis is governed by the well-established principle that, in most contexts, "'a precisely drawn, detailed statute preempts more general remedies.'" *EC Term of Years Trust v. United States*, 550 U.S. ___, ___ (2007), (slip op., at 4) (quoting *Brown v. GSA*, 425 U.S. 820, 834 (1976)); see also *Block v. North Dakota ex rel. Board of Univ. and School Lands*, 461 U.S. 273, 284–286 (1983). We are also guided by our past recognition that when Congress enacts a specific remedy when no remedy was previously recognized, or when previous remedies were "problematic," the remedy provided is generally regarded as exclusive. *Id.* at 285; *Brown, supra*, at 826–829.

Section 6404(h) fits the bill on both counts. It is a "precisely drawn detailed statute" that, in a single sentence, provides a forum for adjudication, a limited class of potential plaintiffs, a statute of limitations, a standard of review, and authorization for judicial relief. And Congress enacted this provision against a backdrop of decisions uniformly rejecting the possibility of any review for taxpayers wishing to challenge the Secretary's Sec. 6404(e)(1) determination. Therefore, despite Congress's failure explicitly to define the Tax Court's jurisdiction as exclusive, we think it quite plain that the terms of Sec. 6404(h)—a "precisely drawn, detailed statute" filling a perceived hole in the law—control all requests for review of Sec. 6404(e)(1) determinations. Those terms include the forum for adjudication.

The Hincks' primary argument against exclusive Tax Court jurisdiction is that by providing a standard of review—abuse of discretion—in Sec. 6404(h), Congress eliminated the primary barrier to judicial review that courts had previously recognized; accordingly, they maintain, taxpayers may seek review of Sec. 6404(e)(1) determinations under statutes granting jurisdiction to the district courts and the Court of Federal Claims to review tax refund actions. See 28 U.S.C. Secs. 1346(a)(1); 1491(a)(1); 26 U.S.C. Sec. 7422(a). Or, as the Fifth Circuit reasoned: "[T]he federal district courts have always possessed *jurisdiction* over challenges brought to section 6404(e)(1) denials[;] they simply determined that the taxpayers had no *substantive right* whatever to a favorable exercise of the Secretary's discretion. . . . [I]n enacting section 6404(h), Congress indicated that such is no longer the case, and thereby removed any impediment to district court review." *Beall, supra*, at 428 (emphasis in original).

It is true that by providing an abuse of discretion standard, Congress removed one of the obstacles courts had held foreclosed judicial review of Sec. 6404(e)(1) determinations. See, *e.g., Argabright*, 35 F.3d at 476 (noting an absence of "'judicially manageable standards'" (quoting *Heckler*, 470 U.S. at 830)). But in enacting Sec. 6404(h), Congress did not simply supply this single missing ingredient; rather, it set out a carefully circumscribed, time-limited, plaintiff-specific provision which also precisely defined the appropriate forum. We cannot accept the Hincks' invitation to isolate one feature of this "precisely drawn, detailed statute" —the portion specifying a standard of review—and use it to permit taxpayers to circumvent the other limiting features Congress placed in the *same* statute—restrictions such as a shorter statute of limitations than general refund suits, compare Sec. 6404(h) (180-day limitations period) with Sec. 6532(a)(1) (2-year limitations period), or a net-worth ceiling for plaintiffs eligible to bring suit. Taxpayers could "effortlessly evade" these specific limitations by bringing interest abatement claims as tax refund actions in the district courts or the Court of Federal Claims, disaggregating a statute Congress plainly envisioned as a package deal. *EC Term of Years Trust, supra*, at ___ (slip op., at 5); see also *Block, supra*, at 284–285; *Brown, supra*, 425 U.S. at 832–833.

The Hincks' other contentions are equally unavailing. First, they claim that

[1] The Taxpayer Bill of Rights 2 also modified 26 U.S.C. Sec. 6404(e)(1)(A) to add the word "unreasonable" before the words "error or delay" and to change "ministerial act" to "ministerial or managerial act." Sec. 301(a), 110 Stat. 1457. These changes, however, only apply to interest accruing on deficiencies for tax years beginning after July 30, 1996, see Sec. 301(c), *ibid.*, and thus are not implicated in this case.

reading Sec. 6404(h) to vest exclusive jurisdiction in the Tax Court impliedly repeals the preexisting jurisdiction of the district courts and Court of Federal Claims, despite our admonition that "repeals by implication are not favored." *Morton v. Mancari*, 417 U.S. 535, 549 (1974) (internal quotation marks omitted). But the implied-repeal doctrine is not applicable here, for when Congress passed Sec. 6404(h), Sec. 6404(e)(1) had been interpreted not to provide *any* right of review for taxpayers. There is thus no indication of any "language on the statute books that [Congress] wishe[d] to change," *United States v. Fausto*, 484 U.S. 439, 453 (1988), implicitly or explicitly. Congress simply prescribed a limited form of review where none had previously been found to exist.

Second, the Hincks assert that vesting jurisdiction over Sec. 6404(e)(1) abatement decisions exclusively in the Tax Court runs contrary to the "entire structure of tax controversy jurisdiction," Brief for Petitioners 30, under which the Tax Court generally hears prepayment challenges to tax liability, see Sec. 6213(a), while postpayment actions are brought in the district courts or Court of Federal Claims. In a related vein, the Hincks point out that the Government's position would force taxpayers seeking postpayment review of their tax liabilities to separate their Sec. 6404(e)(1) abatement claims from their refund claims and bring each in a different court. Even assuming, *arguendo*, that we were inclined to depart from the face of the statute, these arguments are undercut on two fronts. To begin with, by expressly granting to the Tax Court *some* jurisdiction over Sec. 6404(e)(1) decisions, Congress has already broken with the general scheme the Hincks identify. No one doubts that an action seeking review of a Sec. 6404(e)(1) determination may be maintained in the Tax Court even if the interest has already been paid, see, *e.g., Dadian v. Commissioner*, 87 TCM 1344 (2004), ¶2004–121 RIA Memo TC, p. 790–2004; *Miller v. Commissioner*, 79 TCM 2213 (2000), ¶2000–195 RIA Memo TC, p. 1120–2000, aff'd, 310 F.3d 640 (CA9 2002), and the Hincks point to no case where the Tax Court has refused to exercise jurisdiction under such circumstances.

In addition, an interest abatement claim under Sec. 6404(e)(1) involves no questions of substantive tax law, but rather is premised on issues of bureaucratic administration (whether, for example, there was "error or delay" in the performance of a "ministerial" act, Sec. 6404(e)(1)(A)). Judicial review of decisions not to abate requires an evaluation of the internal processes of the IRS, not the underlying tax liability of the taxpayer. We find nothing tellingly awkward about channeling such discrete and specialized questions of administrative operations to one particular court, even if in some respects it "may not appear to be efficient" as a policy matter to separate refund and interest abatement claims. 446 F.3d at 1316.[2]

Last, the Hincks contend that Congress would not have intended to vest jurisdiction exclusively in the Tax Court, because it would lead to the "unreasonable" result that taxpayers with net worths greater than $2 million (for individuals) or $7 million (for businesses) would be foreclosed from seeking judicial review of Sec. 6404(e)(1) refusals to abate. Brief for Petitioners 46; see also *Beall*, 336 F.3d at 430. But we agree with the Federal Circuit that this outcome "was contemplated by Congress." 446 F.3d at 1316. The net-worth limitation in Sec. 6404(h) reflects Congress's judgment that wealthier taxpayers are more likely to be able to pay a deficiency before contesting it, thereby avoiding accrual of interest during their administrative and legal challenges. In contrast, taxpayers with comparatively fewer resources are more likely to contest their assessed deficiency before first paying it, thus exposing themselves to interest charges if their challenge is ultimately unsuccessful. There is nothing "unreasonable" about Congress's decision to grant the possibility of judicial relief only to those taxpayers most likely to be in need of it.[3]

The judgment of the United States Court of Appeals for the Federal Circuit is affirmed.

It is so ordered.

[2] We note that the Hincks sought only interest abatement in the Court of Federal Claims, thus failing to implicate the "claim-splitting" and efficiency concerns they condemn. See Brief for Petitioners 49.

[3] The Hincks also argue that the net-worth limitations on Sec. 6404(h) review violate the due process rights of those taxpayers who exceed them. The court below did not pass upon this constitutional challenge, nor do we, for, as the Hincks concede, the record contains no findings concerning their own net worth, Brief for Petitioners 44, and they offer no reasons to deviate from our general rule that a party "must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties." *Kowalski v. Tesmer*, 543 U.S. 125, 129 (2004) (quoting *Warth v. Seldin*, 422 U.S. 490, 499 (1975); internal quotation marks omitted).

Social Security Contribution and Benefit Base for 2008

Notice 2007–92

Under the authority contain in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (72 F.R. 60703, dated October 24, 2007) that the contribution and benefit base for remuneration paid in 2008, and self-employment income earned in tax years beginning in 2008 is $102,000.

"Old-Law" Contribution and Benefit Base

General

The "old-law" contribution and benefit base for 2008 is $75,900. This is the base that would have been effective under the Act without the enactment of the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) the Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(c) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

Domestic Employee Coverage Threshold

General

The minimum amount a domestic worker must earn so that such earnings are covered under Social Security or Medicare is the domestic employee coverage threshold. For 2008, this threshold is $1,600. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

Computation

Under the formula, the domestic employee coverage threshold amount for 2008 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 2006 to that for 1993. If the resulting amount is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

Domestic Employee Coverage Threshold Amount

Multiplying the 1995 domestic employee coverage threshold amount ($1,000) by the ratio of the national average wage index for 2006 ($38,651.41) to that for 1993 ($23,132.67) produces the amount of $1,670.86. We then round this amount to $1,600. Accordingly, the domestic employee coverage threshold amount is $1,600 for 2008.

(Filed by the Office of the Federal Register on October 24, 2007, 8:45 a.m., and published in the issue of the Federal Register for October 25, 2007, 72 F.R. 60703)

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

User Fees Relating to Enrollment to Perform Actuarial Services

REG–134923–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to user fees for the initial and renewed enrollment to become an enrolled actuary. The charging of user fees is authorized by the Independent Offices Appropriations Act (IOAA) of 1952. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 26, 2007. Outlines of topics to be discussed at the public hearing scheduled for November 26, 2007, at 10 a.m., must be received by November 19, 2007.

ADDRESSES: Send comments to: CC:PA:LPD:PR (REG–134923–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–134923–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC. Alternatively, submissions may be sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–134923–07).

FOR FURTHER INFORMATION CONTACT: Concerning submissions of comments and/or to be placed on the building access list to attend the hearing *Richard.A.Hurst@irscounsel.treas.gov* or at (202) 622–7180; concerning cost methodology, Eva J. Williams at (202) 435–5514; concerning the proposed regulations, Joel Rutstein at (202) 622–4940 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Employee Retirement Income Security Act of 1974 (Public Law 93–406) ordered the Secretary of Labor and the Secretary of Treasury to establish a Joint Board for the Enrollment of Actuaries. 29 U.S.C. 1241. The Joint Board shall, by regulation, establish reasonable standards and qualifications for persons performing actuarial services and the Joint Board shall enroll such individuals who, upon application, satisfy such standards and qualifications. 29 U.S.C. 1242(a). The regulations at 20 CFR Part 901, Subpart B address eligibility for enrollment and renewal of enrollment. Pursuant to the Joint Board's bylaws, the Secretary of the Treasury is to appoint an Executive Director to the Board who has the delegated authority to administer the Board's enrollment program. The Secretary of the Treasury has delegated these functions to the Internal Revenue Service and the costs of these activities are borne by the Service.

20 CFR 901.11(d)(4) provides for a reasonable non-refundable fee for applications for renewal of enrollment. Form 5434–A, "*Application for Renewal of Enrollment*" presently states that the renewal fee is $25. Proposed 26 CFR 300.7 and 300.8 establish separate $250 user fees for the enrollment and renewal of enrollment process. These fees represent the IRS's costs in administering the program, and the $250 fee for renewal of enrollment will supplant the $25 fee.

Authority

The IOAA of 1952 (31 U.S.C. 9701) authorizes agencies to prescribe regulations that establish charges for services provided by the agency. The charges must be fair and be based on the costs to the Government, the value of the service to the recipient, the public policy or interest served, and other relevant facts. The IOAA of 1952 provides that regulations implementing user fees are subject to policies prescribed by the President, which are currently set forth in OMB Circular A–25, 58 FR 38142 (July 15, 1993) (the OMB Circular).

The OMB Circular encourages user fees for government-provided services that confer benefits on identifiable recipients over and above those benefits received by the general public. Under the OMB Circular, an agency that seeks to impose a user fee for government-provided services must calculate its full cost of providing those services. In general, a user fee should be set at an amount in order for the agency to recover the cost of providing the special service, unless the Office of Management and Budget grants an exception. Pursuant to the guidelines in the OMB Circular, the IRS has calculated its cost of providing services under the enrolled actuaries program. The IRS has determined that the full cost of administering the enrollment and re-enrollment processes is $250 per enrolled actuary per process.

The proposed user fees will be implemented under the authority of the IOAA of 1952 and the OMB Circular.

Proposed Effective Date

These regulations are proposed to apply thirty days after the date of publication in the **Federal Register** of the final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This certification is based on the information that follows. These proposed rules affect enrolled actuaries, of which there are currently 4,600 active. The economic impact of these regulations on any small entity would result from a small entity, including a sole proprietor, being required to pay a fee prescribed by these regulations in order to obtain a particular service. The appropriate NAICS

codes for enrolled actuaries relate to Insurance Other (524298) and Administrative and General Management Consulting, Including Financial Consulting (541611). Entities identified under these codes are considered small under the SBA size standards (13 CFR 121.201) if their annual revenue is less than $6.5 million. The IRS estimates that as many as 2,070 enrolled actuaries may be operating as or employed by small entities. Therefore, the IRS has determined that these proposed rules will affect a substantial number of small entities. The dollar amounts of the fees are not, however, substantial enough to have a significant economic impact on any entity subject to the fees. The amounts of the fees are commensurate with, if not less than, the amount charged by professional organizations. Persons who elect to apply for enrollment or renewal of enrollment also receive benefits from obtaining the enrolled actuary designation. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the substance of the proposed regulations, as well as on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 26, 2007 at 10:00 a.m. in room 3716. Due to building security procedures, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments by November 26, 2007 and an outline of the comments to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by November 19, 2007. A period of ten (10) minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Joel S. Rutstein of the Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 300 is proposed to be amended as follows:

PART 300—USER FEES

Paragraph 1. The authority citation for part 300 continues to read as follows:

Authority: 31 U.S.C. 9701.

Par. 2. Section 300.0 is amended as follows:

1. Paragraphs (b)(7) and (b)(8) are added.

2. Paragraph (c) is revised.

The additions and revision read as follows:

§300.0 User fees, in general.

* * * * *

(b) * * *

(7) Enrolling an enrolled actuary.

(8) Renewing the enrollment of an enrolled actuary.

(c) *Effective/applicability date.* This part 300 is applicable March 16, 1995, except that the user fee for processing offers in compromise is applicable November 1, 2003; the user fee for the special enrollment examination, enrollment, and renewal of enrollment for enrolled agents is applicable November 6, 2006; the user fee for entering into installment agreements on or after January 1, 2007, is applicable January 1, 2007; the user fee for restructuring or reinstatement of an installment agreement on or after January 1, 2007, is applicable January 1, 2007; and the user fee for the enrollment and renewal of enrollment for enrolled actuaries is applicable thirty days after the date of publication in the **Federal Register** of the final regulations.

Par. 3. Section 300.7 is added to read as follows:

§300.7 Enrollment of enrolled actuary fee.

(a) *Applicability.* This section applies to the initial enrollment of enrolled actuaries with the Joint Board for the Enrollment of Actuaries pursuant to 20 CFR Part 901.

(b) *Fee.* The fee for initially enrolling as an enrolled actuary with the Joint Board for the Enrollment of Actuaries is $250.00.

(c) *Person liable for the fee.* The person liable for the enrollment fee is the applicant filing for enrollment as an enrolled actuary with the Joint Board for the Enrollment of Actuaries.

Par. 5. Section 300.8 is added to read as follows:

§300.8 Renewal of enrollment of enrolled actuary fee.

(a) *Applicability.* This section applies to the renewal of enrollment of enrolled actuaries with the Joint Board for the Enrollment of Actuaries pursuant to 20 CFR Part 901.

(b) *Fee.* The fee for renewal of enrollment as an enrolled actuary with the Joint Board for the Enrollment of Actuaries is $250.00.

(c) *Person liable for the fee.* The person liable for the renewal of enrollment fee is the person renewing their enrollment as an enrolled actuary with the Joint Board for the Enrollment of Actuaries.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 26, 2007, 4:29 p.m., and published in the issue of the Federal Register for October 31, 2007, 72 F.R. 61583)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-104

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007

Name	Address	Designation	Date of Reinstatement
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007

Name	Address	Designation	Date of Suspension
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007

Name	Address	Designation	Date of Suspension
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007

Name	Address	Designation	Date of Suspension
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Foundations Status of Certain Organizations

Announcement 2007–108

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

A Plus Care Development, Inc., San Bernardino, CA
ABC Ministry & Counseling Center, Inc., Brooklyn, NY
Advantage Rutherford Foundation, Rutherfordton, NC
AFRI — Assistance for Refugees, Inc., Brooklyn, NY
Angels of Mercy Aviation Corp., Inc., Warrensburg, MO
Babblingbrook Family Learning Center, Inc., East Boston, MA
Bayside Lions Service, Inc., Bacliff, TX
Big Picture Social Marketing, Overbrook, KS
Big P.L.A.Y. (Planning, Life, Athletic, Youth) League, Alta Loma, CA
Brothers of One Kind Child Development and Learning Center, Moreno Valley, CA
CAFMA, Inc., St. Albans, NY
Caring and Sharing for the Homeless, Inc., Ellicott City, MD
Case Management Resources, Inc., Ridgway, PA
Center for Adaptive Policy in Ecosystems, Mukilteo, WA
Concerts by the Sea, Swampscott, MA
Crosswoods Entertainment Incorporated, Santa Monica, CA
Daybreakers Foundation, Branson, MO
Dimension Family Development, Stafford, VA
Discover America Foundation, Richmond, CA
Dormay Learning Institute, Incorporated, Miami, FL
Dunleith Railroad Historical Society, East Dubuque, IL
Eastside Extreme, Bothell, WA
Family Institute, Inc., Lexington, KY
Foundation for Learning Development, Manhattan Beach, CA
Free Energy, South Lake Tahoe, CA
Friends of City University, Inc., Washington, DC
Global Foundation for Education Development, Inc., Arlington, VA
Good Samaritan Corporation, Burlington, NJ
Great Commission International Ministries, Cullman, AL
Greenlife Enrichment, Inc., Pasadena, CA
Hearts Senior Citizens, Denver, CO
Historic Herbert House Events Facility, Vallejo, CA
Hollywood Community Corporation, Inc., Fayette, MS
Homeplanner Institute, Houston, TX
Hope for the Hurting Ministries, Inc., Mesa, AZ
Indiana Public Health Institute, Inc., Indianapolis, IN
Individuals With Disabilities Enabling Advocacy Link-IDEAL, Bedminister, NJ
International Brotherhood in Recovery, Sunrise, FL
International Center for Ethics and Workforce Readiness, Panama City Beach, FL
James Thompson Community Development, Inc., Pensacola, FL
Just Alternatives, Brooklin, MA
Juventud Encantador, Hillsborough, CA
Kendrick Foundation, Inc., Mooresville, IN
Kims Extended Learning Center, Inc., Memphis, TN
Kosas, New Orleans, LA
KWJWD Ministries, Moreno Valley, CA
Life Care Ministries, Inc., Fort Pierce, FL
Lupus Clinical Trials Consortium, Princeton, NJ
Malcolm X— Ella L. Little Collins Family Foundation, Inc., Boston, MA
Markee Pet Refuge, Salem, OR
MB Comprehensive Social Services, Compton, CA
Me Too Youth Foundation, Oakland, CA
Michael Jefferson Outreach Ministries, Starkville, MS
Militis Christi, Inc., Austin, TX
Ministries of the Well, Albuquerque, NM

Mount Olive Community Development Corporation, Riverside, CA
Multgenerational Outreach Center, Inc., Missouri City, TX
MVP Outreach, Inc., Greenville, SC
National Council on Paint Disposition, Inc., East Brunswick, NJ
National Organization of Pacific Islanders in America, Waldorf, MD
No-Charge Cards, Nassau, NY
North American Foundation for Keele University, Inc., New York, NY
North Carolina Cotton Foundation, Inc., Nashville, NC
Olive Branch Animal Rescue & Refuge, Inc., Sistersville, WV
Omni Educational & Cultural Foundation, St. Charles, MO
One Village, Inc., Lilburn, GA
Paragon Payee Services, Inc., Vancouver, WA
Pardada Pardadi Educational Society, Inc., Fairfax, VA
Payton Memorial Education Foundation, Inc., Hialeah, FL
PEAK Institute, Inc., Adrian, MI
Pentacle Educational, Inc., Hazel Crest, IL
Premier Youth Opportunity Center, West Covina, CA
Progressive Development Corporation, Gloucester, MA
Project Outreach — Early Breast Care Education Screening & Advocacy, Inc., Oklahoma City, OK
Rainbow Wellness Center, Galloway, NJ
Red Hill Community Unit 10 Academic Foundation, Bridgeport, IL
Restoring Hope, Inc., New Orleans, LA
Richard A. Coz SJ Foundation, Ltd., Redwood City, CA
Rohnert Park Boards and Blades Corporation, Rohnert Park, CA
Rosa Parks School Collaborative, Berkley, CA
Scott Anderson Ministries, Inc., Kalamazoo, MI
Shalom Oasis Ministries, Inc., Raleigh, NC
Societa Dante Alighier, Inc., Isle of Palms, SC
Spelling Bee Competition, Inc., Chicago, IL
Ssanyu Youth Aid International, Farmington Hills, MI
Tedrow Home Educators Network, Wauseon, OH
They Are Helping People, New Caney, TX
Towpath Lodge Association, Inc., Brockport, NY
Universal Haitian Development & Relief Fund, Inc., Bridgeport, GA
Vision and Leadership Community Foundation, Frisco, TX
Vision Communities, Inc., Indianapolis, IN
Water Walker Ministries Incorporated, Fayetteville, GA
Wes Becker Public School Survival Fund, Inc., Eugene, OR
We Will Stand, Burbonnais, IL
Work-Scholarship Connection, Inc., Oxford, NC
Zoe Music Ministries, Inc., Coral Springs, FL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Consolidated Returns; Intercompany Obligations; Correction

Announcement 2007–109

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and withdrawal of proposed regulations.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG–107592–00, 2007–44 I.R.B. 908) and withdrawal of proposed regulations (REG–105964–98, 2007–44 I.R.B. 908) that were published in the **Federal Register** on Friday, September 28, 2007 (72 FR 55139) providing guidance regarding the treatment of transactions involving obligations between members of a consolidated group and the treatment of transactions involving the provision of insurance between members of a consolidated group. The regulations will affect corporations filing consolidated returns.

FOR FURTHER INFORMATION CONTACT: Frances L. Kelly, (202) 622–7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The correction notice that is the subject of this document is under section 1502 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking (REG–107592–00) and withdrawal of proposed regulations (REG–105964–98) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of proposed rulemaking (REG–107592–00) and withdrawal of proposed regulations (REG–105964–98), which were the subjects of FR Doc. E7–19134, is corrected as follows:

1. On page 55142, column 3, in the preamble, under the paragraph heading "E. Material Tax Benefit Rule", eleventh line of the third paragraph, the language "a material tax benefit that would not" is corrected to read "a material Federal tax benefit that would not".

2. On page 55143, column 1, in the preamble, under the paragraph heading "F. Off-Market Issuance Rule", eleventh line of the second paragraph of the column, the language "tax benefit. In such cases, the" is corrected to read "Federal tax benefit. In such cases, the".

3. On page 55143, column 1, in the preamble, under the paragraph heading "G. Outbound Transactions", eighth line of the first paragraph, the language "obligation that became intercompany" is corrected to read "obligation that became an intercompany".

4. On page 55144, column 1, in the preamble, under the paragraph heading "I.

Other Request for Comments", eleventh line of the first full paragraph of the column, the language "and basis (such as the issuance of note" is corrected to read "and basis (such as the issuance of a note".

§ **1.1502–13 [Corrected]**

5. On page 55146, column 2, § 1.1502–13(g)(2)(v), second line of the paragraph, the language "of a material net reduction in income or" is corrected to read "of, for Federal tax purposes, a material net reduction in income or".

6. On page 55146, column 3, § 1.1502–13(g)(3)(i)(B), last line of the paragraph, the language "or (6) of this section apply." is corrected to read "or (6) of this section apply. The exceptions are as follows.".

7. On page 55147, column 3, § 1.1502–13(g)(4)(iii), last line of the paragraph, the language "market interest rates." is corrected to read "market interest rates).".

8. On page 55149, column 2, § 1.1502–13(g)(7)(ii) *Example 2*.(vi), sixth line of the paragraph, the language "as selling all of its assets to X, including the" is corrected to read "as selling all of its assets to new S, including the".

9. On page 55149, column 2, § 1.1502–13(g)(7)(ii) *Example 2*.(vi), seventeenth line of the paragraph, the language "to X for $70, the amount realized with" is corrected to read "to new S for $70. the amount realized with".

10. On page 55150, column 3, § 1.1502–13(g)(7)(ii) *Example 6*.(i), sixth line of the paragraph, the language "repayment of $100 at the end of year 5. The" is corrected to read "repayment of $100 at the end of year 20. The".

11. On page 55151, column 1, § 1.1502–13(g)(7)(ii) *Example 8*.(i), third line of the paragraph, the language "from a separate return limitation year (SRLY)." is corrected to read "from a separate return limitation year that is subject to limitation under § 1.1502–21(c) (a SRLY loss).".

12. On page 55151, column 2, § 1.1502–13(g)(7)(ii) *Example 9*.(i), third through fourth lines of the paragraph, the language "material loss from a separate return limitation year (SRLY). T's sole shareholder," is corrected to read "material SRLY loss. T's sole shareholder,".

13. On page 55151, column 3, § 1.1502–13(g)(7)(ii) *Example 10*.(iii), ninth line of the paragraph, the language "principal amount, and a fair market value of" is corrected to read "principal amount, and fair market value of".

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 417.—Definitions and Special Rules for Purposes of Minimum Survivor Annuity Requirements

26 CFR 1.417(e)–1: Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

Mortality tables; single sum distributions; section 417(e)(3) of the Code. This ruling pertains to the mortality table to be used when calculating a single sum distribution as a result of the amendment of section 417(e)(3) to the Code by the Pension Protection Act. Rev. Rul. 2001–62 modified.

Rev. Rul. 2007–67

ISSUES

1. Do the timing rules for the determination of the applicable interest rate under §§ 1.417(e)–1(d)(4) and 1.417(e)–1(d)(10)(ii) of the Income Tax Regulations continue to apply for distributions with annuity starting dates occurring during plan years beginning on or after January 1, 2008?

2. What mortality table is the applicable mortality table under § 417(e)(3)(B) of the Internal Revenue Code ("Code") for distributions with annuity starting dates occurring during plan years beginning on or after January 1, 2008?

3. Does an amendment that implements the new interest rates and mortality table under § 417(e)(3) violate the requirements of § 411(d)(6)?

LAW AND ANALYSIS

Section 417(e)(3) provides rules for the determination of the present value of plan benefits for purposes of § 417(e). Section 417(e)(3)(A) generally provides that for purposes of § 417(e)(1) and (e)(2), the present value is not permitted to be less than the present value calculated by using the applicable mortality table and the applicable interest rate as defined in § 417(e)(3)(B) and (C) respectively. In addition, § 411(a)(11)(B) provides that the determination of present value for purposes of § 411(a)(11)(A) is calculated in accordance with § 417(e)(3). Sections 203(e)(1), 203(e)(2), and 205(g)(3) of the Employee Retirement Income Security Act of 1974 (ERISA) provide corresponding provisions to §§ 411(a)(11)(A), 411(a)(11)(B), and 417(e)(3) of the Code.

Section 1.417(e)–1(d)(1) provides that a defined benefit plan must provide that the present value of any accrued benefit and the amount (subject to §§ 411(c)(3) and 415) of any distribution, including a single sum, must not be less than the amount calculated using the applicable interest rate described in § 1.417(e)–1(d)(3) (determined for the month described in § 1.417(e)–1(d)(4)) and the applicable mortality table described in § 1.417(e)–1(d)(2). The present value of any optional form of benefit cannot be less than the present value of the normal retirement benefit determined in accordance with the rules described in the preceding sentence. Under § 1.417(e)–1(d)(1), these rules must also be used to compute the present value of the benefit for purposes of determining whether consent for a distribution is required. Section 1.417(e)–1(d)(6) sets forth exceptions from the otherwise applicable minimum present value requirements of § 1.417(e)–1(d)(1). In addition, § 411(a)(13)(A) provides an exception for certain applicable defined benefit plans described in § 411(a)(13)(C).

The U.S. Supreme Court, in *Arizona v. Norris*, 463 U.S. 1073, 1084–1086 (1983), held that the application of sex-distinct actuarial tables to employees based upon their gender in calculating the amount of retirement benefits violates Title VII of the Civil Rights Act of 1964.

For plan years beginning prior to January 1, 2008, § 417(e)(3)(A)(ii)(II) defines the term "applicable interest rate" as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(4) generally provides that a plan must provide for the applicable interest rate to be held constant for a stability period of one calendar month, one plan quarter, one calendar quarter, one plan year, or one calendar year, and that the applicable interest rate for each stability period is the annual rate of interest on 30-year Treasury constant maturities for a specified lookback month that is the first, second, third, fourth, or fifth full calendar month preceding the first day of the stability period.

For plan years beginning prior to January 1, 2008, § 417(e)(3)(A)(ii)(I) defines the term "applicable mortality table" as the mortality table prescribed by the Secretary and provides that such table shall be based on the prevailing commissioners' standard table (described in § 807(d)(5)(A)) used to determine group reserves for group annuity contracts issued on the date as of which the present value is determined. Rev. Rul. 2001–62, 2001–2 C.B. 632, provided the applicable mortality table for plan years beginning prior to January 1, 2008, for distributions with annuity starting dates on or after December 31, 2002. Rev. Rul. 2001–62 also permitted a plan to specify any earlier date in 2002 for the required use of the mortality table set forth in that revenue ruling. Rev. Rul. 95–6, 1995–1 C.B. 80, provided the applicable mortality table for distributions with annuity starting dates prior to the application of Rev. Rul. 2001–62.

For plan years beginning on or after January 1, 2008, section 302 of the Pension Protection Act of 2006, Public Law 109–280 (PPA '06), changed the present value determination under § 417(e)(3) of the Code. For such plan years, § 417(e)(3)(C) defines the term "applicable interest rate" as the adjusted first, second, and third segment rates applied under rules similar to the rules of § 430(h)(2)(C) for the month before the date of the distribution or such other time as the Secretary may by regulations prescribe. For this purpose, the adjusted first, second, and third segment rates are determined without regard to the 24-month averaging provided under § 430(h)(2)(D)(i), and § 417(e)(3)(D)(ii) provides a transition rule that phases in the use of the segment rates over five years.

In addition, for plan years beginning on or after January 1, 2008, § 417(e)(3)(B) defines the term "applicable mortality table"

as a mortality table, modified as appropriate by the Secretary, based on the mortality table specified for the plan year under subparagraph (A) of § 430(h)(3) (without regard to subparagraph (C) or (D) of such section). In contrast to the phase in of the use of the segment rates with regard to the applicable interest rate, there is no transition rule with regard to the applicable mortality table. In addition, PPA '06 left unchanged the mortality table which generally must be used for the purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D).

Notice 2007–81, 2007–44 I.R.B. 899, specifies how the adjusted segment rates that are used to determine minimum present values pursuant to § 417(e)(3) are determined, and specifies those rates for August 2007.

Section § 1.430(h)(3)–1 of the proposed Income Tax Regulations (72 FR 29456) proposes rules for the mortality tables to be used in determining present value or making any computation under § 430. The proposed regulation provides for separate mortality tables for male and females and for annuitants and nonannuitants. The proposed regulation also provides an option for smaller plans to use male and female blended static tables for all participants — in lieu of separate tables for annuitants and nonannuitants. Under the proposed regulation, expected improvements in mortality would be taken into account through the use of static tables that are updated annually, or through the use of generational tables. The proposed regulation provides the static mortality tables that are to be used with respect to valuation dates occurring during 2008. The static mortality tables that are to be used with respect to valuation dates occurring in later years are to be published in the Internal Revenue Bulletin.

Section 411(d)(6)(A) generally prohibits a plan amendment that decreases a participant's accrued benefit. Section 411(d)(6)(B) provides that an amendment that eliminates an optional form of benefit is treated as reducing a participant's accrued benefit, but permits the Secretary of the Treasury to provide for the elimination of certain optional forms of benefits under regulations. Section 1.411(d)–3(a)(1) provides that under § 411(d)(6)(A), a plan is not a qualified plan (and a trust forming part of such plan is not a qualified trust) if a plan amendment decreases the accrued benefit of any plan participant, except as provided under § 412(c)(8)[1] of the Code, section 4281 of the ERISA, or other applicable law.

Under section 1107 of PPA '06, a plan sponsor is permitted to delay adopting a plan amendment pursuant to statutory provisions under PPA '06 (or pursuant to any regulation issued under PPA '06) until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 in the case of governmental plans). This amendment deadline applies to both interim and discretionary amendments that are made pursuant to PPA '06 statutory provisions or any regulation issued under PPA '06. If section 1107 of PPA '06 applies to an amendment of a plan, the plan does not fail to satisfy the requirements of § 411(d)(6) of the Code by reason of the amendment except as provided by the Secretary of the Treasury.

HOLDING

Issue 1

Pursuant to this revenue ruling, the rules of §§ 1.417(e)–1(d)(4) and 1.417(e)–1(d)(10)(ii) regarding the time for determining the applicable interest rate continue to apply for plan years beginning on or after January 1, 2008, without regard to the change in the basis for determining the applicable interest rate. If the first day of the first plan year beginning on or after January 1, 2008, does not coincide with the first day of a stability period for a plan, the applicable interest rate for distributions with annuity starting dates during the stability period that contains the first day of the plan year will change during that period. For distributions with annuity starting dates within that period that are before the effective date of the PPA '06 statutory change, the applicable interest rate is determined without regard to the statutory change, and for distributions with annuity starting dates within that period that are on or after the effective date of the statutory change, the applicable interest rate is determined reflecting the statutory change.

Issue 2

The § 417(e)(3) applicable mortality table for 2008 is published in the Appendix to this revenue ruling (the "2008 Applicable Mortality Table"). This mortality table is based upon a fixed blend of 50 percent of the static male combined mortality rates and 50 percent of the static female combined mortality rates published in § 1.430(h)(3)–1 of the proposed regulations for valuation dates occurring in 2008. The table shows, for each age, the number living based upon a starting population of one million lives at age 1 (l_x), and the annual rate of mortality (q_x).

The § 417(e)(3) applicable mortality table for each subsequent year will be published in the future (the "Subsequent Applicable Mortality Tables"). Except as otherwise stated in future guidance, the applicable mortality table for each subsequent year will be determined from the § 430(h)(3)(A) mortality tables on the same basis as the applicable mortality table for 2008.

In general, the applicable mortality table for a year applies to distributions with annuity starting dates that occur during stability periods that begin during the calendar year to which the applicable mortality table applies. However, pursuant to the effective date rules of PPA '06, the 2008 Applicable Mortality Table does not apply before the first day of the first plan year beginning in 2008. Thus, for example, in the case of a plan with a September 1 to August 31 plan year, and a calendar year stability period, the 2008 Applicable Mortality Table (as well as the applicable interest rates that are based on the § 430(h)(2)(C) segment rates) would not apply to distributions with annuity starting dates prior to September 1, 2008, but would apply to distributions with annuity starting dates beginning on or after September 1, 2008.

A reference in a plan to the applicable § 417(e)(3) mortality table will, as of a particular date, be treated as a reference to the table that applies to distributions with annuity starting dates (other than a retroactive annuity starting date) on that date. Such a reference will mean the 2008 Applicable Mortality Table for annuity starting dates to which that mortality table applies, and each Subsequent Applica-

[1] Changed to § 412(d)(2) by amendments made by PPA '06

ble Mortality Table for annuity starting dates to which the Subsequent Applicable Mortality Table applies. Such a reference would not have to be amended each year to reflect changes in the applicable mortality table. By contrast, a plan provision that specifically refers to an annual applicable mortality table (such as the 2008 Applicable Mortality Table) would have to be amended each year to reflect Subsequent Applicable Mortality Tables, and such amendments would have to satisfy § 411(d)(6).

Issue 3

Pursuant to section 1107 of PPA '06, an amendment to determine the applicable interest rate under the § 417(e)(3) rules in effect for plan years beginning on or after January 1, 2008, will not violate § 411(d)(6) of the Code or the corresponding provision of ERISA solely because of a reduction in accrued benefits or a reduction in the amount of any distribution with an annuity starting date occurring during a plan year beginning in 2008 or in a subsequent year if the cause of such reduction is the substitution of the modified segment rates for the 30-year Treasury rate for the same period. However, if the amendment changes the time for determining the interest rate, the requirements of § 1.417(e)–1(d)(10)(ii) must be satisfied. In addition, if the cause of the reduction is an amendment to substitute the modified segment rates for a rate that is not the 30-year Treasury rate, the amendment must satisfy § 411(d)(6).

Pursuant to section 1107 of PPA '06, a plan amendment to incorporate by reference the applicable mortality table under § 417(e)(3) that is prescribed by this revenue ruling and by subsequent guidance issued by the Commissioner will not violate § 411(d)(6) of the Code or the corresponding provision of ERISA solely because of a reduction in accrued benefits or a reduction in the amount of any distribution with an annuity starting date occurring during a plan year beginning in 2008 or in a subsequent year if the cause of such reduction is the substitution of the applicable § 417(e)(3) mortality table for the prior applicable mortality table under § 417(e)(3).

EFFECTIVE DATE

This revenue ruling is effective for plan years that begin on or after January 1, 2008.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2001–62 is modified.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lawrence Isaacs of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Service and the Treasury Department participated in preparing this revenue ruling. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday (a toll-free number). Mr. Isaacs may be e-mailed at *RetirementPlanQuestions@irs.gov*.

APPENDIX

2008 Applicable Mortality Table

Age	l_x	q_x
1	1,000,000.00	0.000380
2	999,620.00	0.000252
3	999,368.10	0.000200
4	999,168.23	0.000153
5	999,015.36	0.000139
6	998,876.50	0.000132
7	998,744.65	0.000126
8	998,618.81	0.000114
9	998,504.97	0.000110
10	998,395.13	0.000111
11	998,284.31	0.000114
12	998,170.51	0.000118
13	998,052.73	0.000124
14	997,928.97	0.000135
15	997,794.25	0.000145
16	997,649.57	0.000154
17	997,495.93	0.000164
18	997,332.34	0.000170
19	997,162.79	0.000174
20	996,989.28	0.000177
21	996,812.81	0.000182
22	996,631.39	0.000189
23	996,443.03	0.000200
24	996,243.74	0.000210
25	996,034.53	0.000224
26	995,811.42	0.000246
27	995,566.45	0.000255
28	995,312.58	0.000264
29	995,049.82	0.000278
30	994,773.20	0.000303
31	994,471.78	0.000350
32	994,123.71	0.000396
33	993,730.04	0.000441
34	993,291.81	0.000486
35	992,809.07	0.000529
36	992,283.87	0.000569
37	991,719.26	0.000608
38	991,116.29	0.000636
39	990,485.94	0.000664
40	989,828.26	0.000698
41	989,137.36	0.000738
42	988,407.38	0.000784
43	987,632.47	0.000836
44	986,806.81	0.000897
45	985,921.64	0.000954
46	984,981.07	0.001010
47	983,986.24	0.001072
48	982,931.41	0.001150
49	981,801.04	0.001237
50	980,586.55	0.001347
51	979,265.70	0.001449
52	977,846.74	0.001597
53	976,285.12	0.001793
54	974,534.64	0.002020
55	972,566.08	0.002378
56	970,253.32	0.002853
57	967,485.19	0.003279
58	964,312.81	0.003746
59	960,700.49	0.004251
60	956,616.55	0.004856
61	951,971.22	0.005634
62	946,607.81	0.006471
63	940,482.31	0.007518
64	933,411.76	0.008493
65	925,484.29	0.009602
66	916,597.79	0.010968
67	906,544.55	0.012222
68	895,464.76	0.013448
69	883,422.55	0.014889
70	870,269.27	0.016329
71	856,058.64	0.017998
72	840,651.30	0.020050
73	823,796.24	0.022220
74	805,491.49	0.024781
75	785,530.61	0.027627
76	763,828.76	0.030695
77	740,383.04	0.034561
78	714,794.66	0.038635
79	687,178.57	0.043206
80	657,488.33	0.048326
81	625,714.55	0.054304
82	591,735.75	0.061007
83	555,635.73	0.067895
84	517,910.84	0.076183
85	478,454.84	0.085221
86	437,680.44	0.095318
87	395,961.62	0.107508
88	353,392.58	0.120363
89	310,857.19	0.134135
90	269,160.36	0.149293
91	228,976.60	0.163173

Age	l_x	q_x
92	191,613.80	0.178866
93	157,340.61	0.194378
94	126,757.06	0.208519
95	100,325.80	0.224167
96	77,836.07	0.237405
97	59,357.40	0.251508
98	44,428.54	0.265606
99	32,628.05	0.276614
100	23,602.67	0.286677
101	16,836.33	0.301731
102	11,756.29	0.313092
103	8,075.49	0.324542
104	5,454.65	0.335529
105	3,624.46	0.345501
106	2,372.21	0.353906
107	1,532.67	0.361363
108	978.82	0.368721
109	617.91	0.375772
110	385.72	0.382309
111	238.26	0.388123
112	145.79	0.393008
113	88.49	0.396754
114	53.38	0.399154
115	32.07	0.400000
116	19.24	0.400000
117	11.54	0.400000
118	6.92	0.400000
119	4.15	0.400000
120	2.49	1.000000

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

The Service allows taxpayers, under certain conditions, to request to revise the year of change for a Form 3115, *Application for Change in Accounting Method*, that is pending in the national office and modifies the period for taking into account a net positive section 481(a) adjustment when the Commissioner approves the taxpayer's request to revise the year of change. See Rev. Proc. 2007-67, page 1072.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481–1: Adjustments in general.

The Service allows taxpayers, under certain conditions, to request to revise the year of change for a Form 3115, *Application for Change in Accounting Method*, that is pending in the national office and modifies the period for taking into account a net positive section 481(a) adjustment when the Commissioner approves the taxpayer's request to revise the year of change. See Rev. Proc. 2007-67, page 1072.

Section 905.—Applicable Rules

These temporary and proposed regulations provide rules relating to a United States taxpayer's obligation under section 905(c) to notify the Internal Revenue Service of a foreign tax redetermination, which is a change in foreign tax liability that may affect the taxpayer's foreign tax credit. These regulations also provide rules under section 6689 relating to the civil penalty for failure to notify the IRS of a foreign tax redetermination. See REG-209020-86, page 1075.

26 CFR 1.905–4T: Notification of foreign tax redetermination (temporary).

T.D. 9362

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Foreign Tax Credit: Notification of Foreign Tax Redeterminations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary Income Tax Regulations relating to a United States taxpayer's obligation under section 905(c) of the Internal Revenue Code (Code) to notify the IRS of a foreign tax redetermination, which is a change in the taxpayer's foreign tax liability that may affect the taxpayer's foreign tax credit. This document also contains temporary Procedure and Administration Regulations under section 6689 relating to the civil penalty for failure to notify the IRS of a foreign tax redetermination as required under section 905(c). These temporary regulations affect taxpayers that have paid foreign taxes which have been redetermined and provide guidance needed to comply with statutory changes made to the applicable law by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004. The text of the temporary regulations also serves as the text of the proposed regulations (REG–209020–86) set forth in the notice of proposed rulemaking on this subject published elsewhere in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on November 7, 2007.

Applicability Dates: For dates of applicability, see §§1.905–3T(a), 1.905–4T(f), and 301.6689–1T(e). These regulations generally apply to foreign tax redeterminations occurring in taxable years of United States taxpayers beginning on or after November 7, 2007, where the foreign tax redetermination affects the amount of foreign taxes paid or accrued by a United States taxpayer. Where the redetermination of foreign tax paid or accrued by a foreign corporation affects the amount of foreign taxes deemed paid under section 902 or 960, this section applies to foreign tax redeterminations occurring in a taxable year of a foreign corporation which ends with or within the taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. Section 1.905–3T(b) generally applies to taxes paid or accrued in taxable years of United States taxpayers beginning on or after November 7, 2007, and to taxes paid or accrued by a foreign corporation in its taxable year which ends with or within the taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. For foreign tax redeterminations occurring in taxable years of United States taxpayers beginning before November 7, 2007, and foreign tax redeterminations occurring in taxable years of a foreign corporation which end with or within the taxable year of the domestic corporate shareholder beginning before November 7, 2007, see §1.905–4T(f)(2).

FOR FURTHER INFORMATION CONTACT: Teresa Burridge Hughes, (202) 622–3850 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public comment pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1056. Responses to this collection of information are mandatory.

The collections of information in these temporary regulations are in §1.905–4T. This information is required in order for taxpayers to notify the IRS of a foreign tax redetermination that may require redetermination of the taxpayer's United States tax liability.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

For further information concerning these collections of information; where to submit comments on the collections of information and the accuracy of the estimated burden; and suggestions for reducing this burden, please refer to the preamble of the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 905(c) and the regulations, a taxpayer that claims a foreign tax credit for taxes paid or accrued under section 901 or deemed paid under section 902 or 960 must notify the IRS when there has been a change to the amount of foreign taxes paid or accrued. In general, in the case of a foreign tax redetermination with respect to taxes claimed as a direct credit under section 901, the taxpayer's United States tax liability must be redetermined; and, in the case of a foreign tax redetermination with respect to taxes included in the computation of foreign taxes deemed paid under section 902 or 960, the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes must be adjusted (subject to exceptions described in §§1.905–3T(d)(3) and (f)). If the taxpayer fails to notify the IRS of a foreign tax redetermination, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, section 6689 imposes a penalty of 5 percent of the deficiency attributable to such redetermination if the failure is for not more than 1 month, with an additional 5 percent for each additional month during which the failure continues, but not to exceed 25 percent of the deficiency.

On June 23, 1988, the **Federal Register** published proposed (53 FR 23659) (INTL–061–86, 1988–2 C.B. 824) and temporary (53 FR 23611) (T.D. 8210, 1988–2 C.B. 248) amendments to the Income Tax Regulations (26 CFR part 1) under section 905(c) and to the Procedure and Administration Regulations (26 CFR part 301) under section 6689 (the 1988 proposed and temporary regulations). These amendments reflected the changes made to the Internal Revenue Code by section 2(c)(2) of the Revenue Act of December 28, 1980 (94 Stat. 3503, 3509) and section 1261(a) of the Tax Reform Act of 1986 (100 Stat. 2085, 2591). The IRS and the Treasury Department received several written comments, which are discussed in this preamble. A public hearing concerning the proposed regulations was neither requested nor held. In response to written comments, on March 16, 1990, the IRS and the Treasury Department issued Notice 90–26, 1990–1 C.B. 336 (see §601.601(d)(2)(ii)(*b*)), which suspended a portion of the temporary regulations, specifically §1.905–3T(d)(2)(ii)(A) and that part of §1.905–3T(d)(2)(ii)(C) which refers to that regulation, which provided rules for accounting for foreign tax redeterminations that affect the calculation of foreign taxes deemed paid with respect to distributions or inclusions out of post-1986 undistributed earnings of a foreign corporation. Section 1.905–3T(d)(2)(ii)(A) required that, in the case of a foreign tax redetermination that affects the amount of foreign taxes deemed paid by a United States corporation for a taxable year, if the foreign tax redetermination occurs more than 90 days before the due date (with extensions) of the taxpayer's income tax return for such taxable year and before the taxpayer actually files that return, then that taxpayer must adjust the foreign tax credit to be claimed on that return for such taxable year to account for the effect of the foreign tax redetermination.

Alternatively, if a foreign tax redetermination occurs after the filing of the United States tax return, §1.905–3T(d)(2)(ii)(B) provides that appropriate upward or downward adjustments are made at the time of the foreign tax redetermination to the pools of post-1986 foreign income taxes and post-1986 undistributed earnings of the foreign corporation. Section 1.905–3T(d)(2)(ii)(C) provides that, if the foreign tax redetermination occurs within 90 days of the due date of the United States tax return and before the taxpayer actually files its tax return, then the taxpayer may elect either to adjust the foreign tax credit to be claimed on that return in the manner described in §1.905–3T(d)(2)(ii)(A) or adjust the pools of post-1986 foreign income taxes and post-1986 undistributed earnings to reflect the effect of the foreign tax redetermination in the manner described in §1.905–3T(d)(2)(ii)(B).

Comments received by the IRS and the Treasury Department concerning the requirement in §1.905–3T(d)(2)(ii)(A) to notify the IRS of a foreign tax redetermination by adjusting the foreign tax credit on the return for the taxable year in which the foreign tax redetermination occurred stated that this requirement did not take into account the amount of time that taxpayers, especially large multinational corporations, need to prepare their income tax returns. In cases for which a foreign tax redetermination requires a redetermination of United States tax liability, §1.905–4T provides rules generally requiring taxpayers to file amended returns to notify the IRS of the redetermination.

Sections 1102(a)(1) and 1102(a)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 963–966 (1997)), amended sections 986(a) and 905(c), respectively, effective for taxes paid or accrued in taxable years beginning after December 31, 1997. Section 905(c)(1)(B) was added to provide that, if accrued taxes are not paid before the date two years after the close of the taxable year to which such taxes relate, the taxpayer must notify the IRS and redetermine its United States tax liability for the year or years in which it claimed credit for such taxes. Section 986(a)(1)(A) was amended to provide that, for purposes of determining the amount of foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued, the amount of any foreign income taxes (and any adjustment thereto) generally will be translated into dollars using the average exchange rate for the taxable year to which such taxes relate. However, under section 986(a)(1)(B), the spot exchange

rate on the date the taxes are paid is used to translate foreign income taxes that are paid before, or more than two years after, the taxable year to which the taxes relate. Section 986(a)(1)(C) provides that, as determined under regulations, the average exchange rate also will not apply to taxes denominated in inflationary currencies.

Subsequently, section 408(a) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418, 1499 (2004)), modified section 986(a) and provided, effective for taxable years beginning after December 31, 2004, that, at the election of the taxpayer, the average exchange rate will not apply to any foreign income taxes the liability for which is denominated in any currency other than in the taxpayer's functional currency. If the taxpayer so elects, taxes will be translated into dollars using the exchange rates at the time such taxes were paid to the foreign country. See section 986(a)(1)(D)(i). Section 986(a)(1)(D)(ii) provides that this election is also applicable to foreign income taxes attributable to a qualified business unit in accordance with regulations prescribed by the Secretary. On May 15, 2006, the IRS and the Treasury Department issued Notice 2006–47, 2006–1 C.B. 892 (see §601.601(d)(2)(ii)(*b*)), which provides interim rules with respect to this election. The notice provides that a taxpayer may elect to use the payment date exchange rates to translate all foreign income taxes, or it may elect to use the payment date exchange rates to translate only those nonfunctional currency foreign income taxes that are attributable to qualified business units with United States dollar functional currencies. Section 408(b)(1) of the American Jobs Creation Act of 2004 also added a special rule at section 986(a)(1)(E) for taxes paid by regulated investment companies.

In light of the statutory changes to sections 905(c) and 986(a) by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004, the IRS and the Treasury Department believe it is appropriate to issue new proposed and temporary regulations. These new regulations make several significant changes to the rules of the 1988 proposed and temporary regulations to take into account statutory changes and the comments received on the 1988 proposed and temporary regulations, while leaving substantial portions of the 1988 proposed and temporary regulations unchanged. The new temporary regulations will permit the IRS to enforce properly sections 905(c) and 6689 without delay. The significant comments and revisions are described in this preamble.

Explanation of Provisions

I. *Currency Translation Rules*

This document contains temporary Income Tax Regulations relating to the currency translation rules that apply in determining the amount of the foreign tax credit. Section 1.905–3T(b) has been revised to reflect the statutory changes to sections 905(c) and 986(a) by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004. New §1.905–3T(b)(1)(i) provides that, in the case of a taxpayer or a member of a qualified group (as defined in section 902(b)(2)) that takes foreign income taxes into account when accrued, the amount of any foreign taxes denominated in foreign currency that have been paid or accrued, additional tax liability denominated in foreign currency, taxes withheld in foreign currency, or estimated taxes paid in foreign currency will be translated into dollars using the average exchange rate (as defined in §1.989(b)–1) for the United States taxable year to which such taxes relate.

However, new §1.905–3T(b)(1)(ii) provides five exceptions to the general rule that accrual basis taxpayers translate foreign taxes using the average exchange rate. First, §1.905–3T(b)(1)(ii)(A) provides that any foreign taxes denominated in foreign currency that were paid more than two years after the close of the United States taxable year to which they relate will be translated into dollars using the exchange rate as of the date of payment of the foreign taxes.

Second, §1.905–3T(b)(1)(ii)(B) provides that any foreign income taxes paid before the beginning of the United States taxable year to which such taxes relate will be translated into dollars using the exchange rate as of the date of payment of the foreign taxes.

Third, §1.905–3T(b)(1)(ii)(C) provides that any foreign income taxes the liability for which is denominated in any inflationary currency will be translated into dollars using the exchange rate as of the date of payment of the foreign taxes. For this purpose, the term *inflationary currency* means the currency of a country in which there is cumulative inflation during the base period of at least 30 percent, as determined by reference to the consumer price index of the country listed in the monthly issues of International Financial Statistics, or a successor publication, of the International Monetary Fund. For purposes of §1.905–3T(b)(1)(ii)(C), *base period* means, with respect to any taxable year, the thirty-six calendar months immediately preceding the last day of such taxable year. See §1.985–1(b)(2)(ii)(D).

Fourth, under the provisions of §1.905–3T(b)(1)(ii)(D), a taxpayer that is otherwise required to translate foreign income taxes that are denominated in foreign currency using the average exchange rate may elect to translate foreign income taxes into dollars using the exchange rate as of the date of payment of the foreign taxes, provided that the liability for such taxes is denominated in nonfunctional currency. This election may be made for all foreign income taxes or for only those foreign income taxes the liability for which is denominated in nonfunctional currency and that are attributable to qualified business units with United States dollar functional currencies. This election allows taxpayers to avoid a mismatch between the translated dollar amount of foreign tax credit and the translated dollar amount of the foreign income used to pay the tax. The election must be made by attaching a statement to the taxpayer's timely filed return (including extensions) for the first taxable year to which the election applies. The statement must identify whether the election is made for all foreign taxes or only for foreign taxes attributable to qualified business units with a United States dollar functional currency. Once made, the election will apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Commissioner.

Finally, in the case of a regulated investment company (as defined in section 851 and the regulations under that section) which takes into account income on an accrual basis, §1.905–3T(b)(1)(ii)(E) provides that foreign income taxes paid or accrued with respect to such income will be translated into dollars using the exchange rate as of the date the income accrues.

This exception takes account of the special rule at section 852(b)(9) that requires a regulated investment company to take dividends into account on the ex-dividend date, rather than on the later date on which the dividends are paid (and the tax is actually withheld). The translation rule permits greater conformity between the translated dollar amount of dividends paid in foreign currency and the translated dollar amount of taxes withheld from such dividends. For a discussion of the effective dates of the currency translation provisions, see the "Effective Date" section of this document.

Section 1.905–3T(b)(4), concerning the allocation of refunds of foreign tax to the separate categories of income under section 904(d), is not modified by these temporary regulations. Section 1.905–3T(b)(5), which provides rules with respect to the basis of foreign currency that is refunded, is revised to reflect the 1997 and 2004 changes to the currency translation rules, as provided in §1.905–3T(b)(3).

II. *Definition of Foreign Tax Redetermination*

The term "foreign tax redetermination" in §1.905–3T(c) has been revised to reflect the statutory changes made to section 905(c) in the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004. New §1.905–3T(c) provides that, for purposes of §§1.905–3T and 1.905–4T, a foreign tax redetermination means a change in the foreign tax liability that may affect a taxpayer's foreign tax credit. A foreign tax redetermination includes: (1) accrued taxes that when paid differ from the amounts added to post-1986 foreign income taxes or claimed as credits by the taxpayer (such as corrections to overaccruals and additional payments); (2) accrued taxes that are not paid before the date two years after the close of the taxable year to which such taxes relate; (3) any tax paid that is refunded in whole or in part; and (4) for taxes taken into account when accrued but translated into dollars on the date of payment, a difference between the dollar value of the accrued tax and the dollar value of the tax paid attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment.

Section 1.905–3T(d)(1) has been revised to reflect the modified definition in new §1.905–3T(c) of a foreign tax redetermination that results from currency fluctuations, but new §1.905–3T(d)(1) otherwise adopts without amendment the rule in §1.905–3T(d)(1) of the 1988 regulations that provides that no redetermination of United States tax liability is required with respect to such foreign tax redetermination if the amount of such redetermination is less than the lesser of ten thousand dollars or two percent of the total dollar amount of the foreign tax initially accrued with respect to that foreign country for the United States taxable year. Comments requested that this exception be broadened by eliminating the $10,000 limitation and by increasing the percentage ceiling from 2 percent to 5 percent, in order to increase the number of taxpayers eligible for the exception, therefore minimizing the administrative burden of filing amended returns for both taxpayers and the IRS. Since the 1988 temporary regulations were published, the administrative burdens of accounting for exchange rate fluctuations have been substantially reduced by the change in law allowing taxpayers claiming credits on the accrual basis to use annual average exchange rates rather than date of payment exchange rates to translate foreign tax. In addition, the IRS and Treasury Department believe that it is appropriate to limit the exception to a dollar threshold. Accordingly, this comment was not adopted.

III. *Adjustments to Pools of Post-1986 Undistributed Earnings and Post-1986 Foreign Income Taxes*

On March 16, 1990, Notice 90–26, 1990–1 C.B. 336 (see §601.601(d)(2)(ii)(*b*)), suspended §1.905–3T(d)(2)(ii)(A) and that part of §1.905–3T(d)(2)(ii)(C) which refers to §1.905–3T(d)(2)(ii)(A). Prior to its suspension, §1.905–3T(d)(2)(ii)(A) required taxpayers to recompute the foreign tax credit claimed on their current year income tax return to account for foreign tax redeterminations that affect the amount of foreign tax deemed paid under section 902 or 960 and that occurred more than 90 days before the due date (with extensions) of the United States tax return for that taxable year and before the actual filing date. Section 1.905–3T(d)(2)(ii)(C) permitted taxpayers to elect to apply §1.905–3T(d)(2)(ii)(A) to a foreign tax redetermination occurring within 90 days of the due date (with extensions) of the tax return for that taxable year and before the actual filing date.

Section 1.905–3T(d)(2)(ii)(B) of the 1988 regulations requires that, if a foreign tax redetermination occurs after the filing of the United States tax return for such taxable year, then appropriate upward or downward adjustments will be made at the time of the foreign tax redetermination to the foreign corporation's pools of post-1986 foreign taxes and post-1986 earnings and profits to reflect the effect of the foreign tax redetermination in calculating foreign taxes deemed paid with respect to distributions and inclusions (and the amount of such distributions and inclusions) that are includible in taxable years subsequent to the taxable year for which such tax return is filed. The part of §1.905–3T(d)(2)(ii)(C) not suspended by Notice 90–26 allows a taxpayer to elect to adjust the pools of post-1986 foreign taxes and post-1986 earnings and profits to reflect the effect of the foreign tax redetermination in the manner described in §1.905–3T(d)(2)(ii)(B). Notice 90–26 also provided that, pending the issuance of final regulations under section 905(c), redeterminations otherwise subject to §1.905–3T(d)(2)(ii)(A) or (C) were required to be accounted for through adjustment to the appropriate pools of post-1986 earnings and profits and post-1986 foreign taxes in the manner described in §1.905–3T(d)(3) and subject to the exceptions set forth in §1.905–3T(d)(4).

A comment concerning §1.905–3T(d)(2) of the 1988 regulations was received, suggesting that taxpayers be allowed to elect to adjust earnings and profits and tax pools or file an immediate claim for refund, in the case of an additional assessment of foreign tax which generates a potential refund of U.S. tax. Because the taxpayer must wait for a subsequent distribution to benefit from the additional credits, the comment stated that the taxpayer is inappropriately denied an immediate benefit, that is, making a claim for an immediate refund, provided by section 6511(d)(3)(A). Subsequently, the Taxpayer Relief Act of 1997 confirmed the Secretary's regulatory authority to pre-

scribe appropriate adjustments to a foreign corporation's pools of post-1986 foreign income taxes and post-1986 undistributed earnings in lieu of a redetermination, and amended section 905(c)(2) explicitly to provide that no redetermination of U.S. tax shall be made by reason of additional taxes paid more than two years after the year to which they relate. In light of the statutory changes, this comment was not adopted.

Section 1.905–3T(d)(2) of the 1988 regulations has been revised to reflect the provisions of Notice 90–26. New §1.905–3T(d)(2)(i) provides that appropriate upward or downward adjustments will be made at the time of the foreign tax redetermination to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes, in accordance with §1.905–3T(d)(2)(ii), to reflect the effect of the foreign tax redetermination in calculating foreign taxes deemed paid with respect to subsequent distributions and inclusions (and the amount of such distributions and inclusions).

Section 1.905–3T(d)(2)(iii) of the 1988 regulations, which provides rules with respect to the reporting requirements for adjustments to the appropriate pools of post-1986 undistributed earnings and post-1986 foreign income taxes has been revised. The 1988 regulations require that the domestic corporate shareholder attach notice of such adjustments to its return on a yearly basis. In the interest of reducing the reporting requirement burden, this notification requirement has been eliminated. New §1.905–3T(d)(2)(i) refers to §1.905–4T(b)(2), which provides that, where a redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960, and the taxpayer is required to adjust the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes under §1.905–3T(d)(2), the taxpayer is required to notify the IRS of such redetermination by reflecting the adjustments to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes on a Form 1118 for the taxpayer's first taxable year with respect to which the redetermination affects the computation of foreign taxes deemed paid.

The 1988 regulations provide four exceptions to the general rule in §1.905–3T(d)(2) requiring pooling adjustments in lieu of a redetermination of United States tax liability to account for the effect of a redetermination of foreign tax paid or accrued by a foreign corporation on foreign taxes deemed paid under section 902 or 960. A shareholder-level redetermination of United States tax liability is required where the foreign tax liability is denominated in a hyperinflationary currency (see §1.905–3T(d)(4)(i)); where the foreign tax redetermination occurs with respect to foreign taxes deemed paid with respect to a subpart F inclusion or an actual distribution which has the effect of reducing the foreign corporation's pool of post-1986 foreign income taxes below zero (see §1.905–3T(d)(4)(iv)); or where a domestic corporate shareholder of a controlled foreign corporation receives a distribution out of previously taxed earnings and profits and a foreign country imposes tax on the foreign corporation's income, which tax is subsequently reduced (see §1.905–3T(f)). These exceptions are adopted without amendment and have been moved to §1.905–3T(d)(3)(i), (iv), and (vi), respectively, in the new temporary regulations.

The fourth exception, at §1.905–3T(d)(4)(ii) in the 1988 regulations, provides that if the foreign tax liability of a United States taxpayer is in a currency other than a hyperinflationary currency and the amount of foreign tax accrued for the taxable year to a foreign country, as measured in units of foreign currency, exceeds the amount of foreign tax paid to that foreign country for the taxable year by at least two percent, then the IRS, in its discretion, may require a redetermination of United States tax liability, in lieu of an adjustment of the pools of post-1986 undistributed earnings and post-1986 foreign income taxes. Section 1.905–3T(d)(2)(iii) of the 1988 regulations provides that, if a taxpayer may be required to redetermine its United States tax liability under §1.905–3T(d)(4)(ii), the taxpayer must attach a notice of such adjustment to its return for the year with or within which ends the foreign corporation's taxable year during which the foreign tax redetermination occurs. Comments were received with respect to these provisions, requesting that the regulations set forth the factors the IRS would take into account in determining whether to exercise such discretion; the percentage limitation be increased to ten percent; the IRS not enforce this provision if the deficiency resulting from the overaccrual of foreign tax is less than $25,000; and the provision only be used in specific situations, such as consistent overaccrual of foreign taxes. Further, in order to avoid taxpayers being subject to the penalty under section 6689 for failure to notify the IRS within 180 days of the foreign tax redetermination, as required by §1.905–4T(b)(2) of the 1988 regulations, a comment requested that, when the IRS exercises its discretion under §1.905–3T(d)(4)(ii), the date on which such redetermination occurs should be deemed to be the date on which the IRS notifies the taxpayer that a redetermination of U.S. tax liability is required.

In lieu of the discretionary rule in the 1988 temporary regulations, §1.905–3T(d)(3)(ii) of the new regulations requires a redetermination of United States tax liability for all affected years if a foreign tax redetermination occurs with respect to foreign taxes paid by a foreign corporation and such foreign tax redetermination, if taken into account in the taxable year of the foreign corporation to which the foreign tax redetermination relates, has the effect of reducing by ten percent or more the foreign taxes deemed paid by the domestic corporate shareholder under section 902 or 960 in the taxable year of the shareholder with or within which ends the taxable year of the foreign corporation to which the foreign tax redetermination relates or in any intervening taxable year. Thus, a redetermination of the United States taxpayer's deemed paid credit under section 902 or 960 is required by reason of a foreign tax redetermination at the foreign subsidiary level only if the overstatement of the foreign tax credit is substantial in amount, taking into account the effect of the redetermination on the entire tax pool of the foreign subsidiary and not just the tax attributable to the year to which the redetermination relates. This new rule is more consistent with the other three exceptions to pooling adjustments in §1.905–3T(d)(4)(i) and (iv) and §1.905–3T(f) of the 1988 temporary regulations, which are at new §1.905–3T(d)(3)(i), (iv), and (vi). Further,

§1.905–3T(d)(3)(ii) of the new regulations provides consistent treatment among taxpayers, adds certainty as to when adjustments to prior-year section 902 or 960 credits are required, and reduces the administrative burden associated with yearly notification of such foreign tax redeterminations.

A comment requested that the regulations be revised to address the situation where a controlled foreign corporation is sold. In a typical case, the seller of the controlled foreign corporation contracts to indemnify the buyer for any tax deficiencies arising with respect to taxable periods occurring prior to the date of the sale and will be entitled to any refunds relating to such periods. The additional assessments or refunds of tax are reflected as adjustments to the pools of the foreign corporation in the hands of the buyer but accrue economically to the seller. However, the seller derives no U.S. tax benefit or detriment from those additional payments or refunds because it no longer has an economic interest in the foreign corporation. It was suggested that the regulations should provide an additional exception to the pooling rules allowing recomputation of the seller's U.S. tax liability as if the foreign tax redetermination occurred immediately prior to the sale. The IRS and Treasury Department are continuing to study this issue and request comments on the potential scope of an additional exception to the pooling adjustment rules in the context of various types of acquisitions.

Comments are also solicited on other changes that should be made to the 1988 temporary regulations, including changes relating to the statutory changes made by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004.

IV. *Time and Manner of Notification*

A. *Overview of new rules*

New §1.905–4T(a) provides that if, as a result of a foreign tax redetermination (as defined in §1.905–3T(c)), a redetermination of United States tax liability is required under section 905(c) and §1.905–3T(d), the taxpayer must provide notification of the foreign tax redetermination. Section 1.905–4T(b)(1) of the new temporary regulations provides rules with respect to the time and manner of notifying the IRS of a foreign tax redetermination that necessitates a redetermination of United States tax liability. New §1.905–4T(b)(1)(i) sets forth the general rule that, where a redetermination of United States tax liability is required, the taxpayer must notify the IRS by filing an amended return, Form 1118 (*Foreign Tax Credit — Corporations*) or 1116 (*Foreign Tax Credit*), and the statement required under §1.905–4T(c) for the taxable year with respect to which a redetermination of United States tax liability is required. However, where a foreign tax redetermination requires an individual to redetermine the individual's United States tax liability, and as a result of such foreign tax redetermination the amount of creditable taxes paid or accrued by such individual during the taxable year does not exceed the applicable dollar limitation in section 904(k) (currently $300, or $600 in the case of a joint return), the individual will not be required to file Form 1116 with the amended return for such taxable year if the individual satisfies the requirements of section 904(k).

B. *Revision of 1988 temporary regulations in response to comments*

The 1988 temporary regulations at §1.905–4T(b)(2) require taxpayers to notify the IRS of a foreign tax redetermination that reduced the amount of foreign taxes paid or deemed paid by filing an amended return for the affected year or years within 180 days after the date that the foreign tax redetermination occurred. The IRS and the Treasury Department received several comments suggesting that this rule was unduly burdensome to taxpayers. The comments noted that multiple foreign tax redeterminations requiring a redetermination of United States tax liability for the same taxable year would require the filing of multiple returns for such year, and that filing an amended Federal tax return would trigger additional state tax notification and amended return filing requirements.

In light of these comments, the new temporary regulations at §1.905–4T(b)(1)(ii) provide that, if a foreign tax redetermination reduced the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, a taxpayer must file a separate notification for each taxable year with respect to which a redetermination of United States tax liability is required by the due date (with extensions) of the original return for the taxable year in which the foreign tax redetermination occurred. With respect to a foreign tax redetermination that increased the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, new §1.905–4T(b)(1)(iii) adopts the rule provided in the 1988 temporary regulations at §1.905–4T(b)(2) and provides that the taxpayer must file a separate notification for each taxable year with respect to which a redetermination of United States tax liability is required within the period provided by section 6511(d)(3)(A).

C. *Special rules for certain redeterminations*

The new temporary regulations at §1.905–4T(b)(1)(iv) provide that, where more than one foreign tax redetermination requires a redetermination of United States tax liability for the same taxable year and those redeterminations occur within two consecutive taxable years of the taxpayer, the taxpayer may file for such taxable year one amended return, Form 1118 or 1116, and the statement required under §1.905–4T(c) that reflect all such foreign tax redeterminations. If the taxpayer chooses to file one notification for such foreign tax redeterminations, the due date for such notification is the due date of the original return (with extensions) for the year in which the first foreign tax redetermination that reduced foreign tax liability occurred. However, because foreign tax redeterminations with respect to the taxable year for which a redetermination of United States tax liability is required may occur after the due date for providing such notification in the later of the two consecutive years, more than one amended return may be required with respect to that taxable year.

Section 1.905–4T(b)(1)(v) of the new temporary regulations provides that, where a foreign tax redetermination requires a redetermination of United States tax liability that would otherwise result in an additional amount of United States tax due, but such amount is eliminated as a result of a carryback or carryover of an unused foreign

tax under section 904(c), the taxpayer may, in lieu of applying the general notification rule described in §1.905–4T(b)(1)(i) or (ii), notify the IRS by attaching a statement to the original return for the taxable year in which the foreign tax redetermination occurs. The statement must be filed by the due date (with extensions) of such return and contain the information described in §1.904–2(f), including the amounts carried back or over to the year with respect to which a redetermination of United States tax liability is required.

The 1988 temporary regulations at §1.905–3T(d)(2)(iii) provide rules concerning the time, manner, and contents of the notification statement for an adjustment of a foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes due to a foreign tax redetermination. The new temporary regulations, at §1.905–4T(b)(2), modify the reporting requirement with respect to such pooling adjustments by providing that where a redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960, and the taxpayer is required to adjust the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes under §1.905–3T(d)(2), the taxpayer must notify the IRS of the redetermination by reflecting the adjustments to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes on a Form 1118 for the taxpayer's first taxable year with respect to which the redetermination affects the computation of foreign taxes deemed paid. New §1.905–4T(b)(2) requires the taxpayer to file the Form 1118 by the due date (with extensions) of the original return for such taxable year. In the case of multiple redeterminations that affect the computation of foreign taxes deemed paid for the same taxable year and that are required to be reported under new §1.905–4T(b)(2), a taxpayer may file one notification for all such redeterminations in lieu of filing a separate notification for each such redetermination.

D. *Large and mid-size business taxpayers*

Section 1.905–4T(b)(2) of the 1988 temporary regulations requires a taxpayer to notify the IRS of a foreign tax redetermination that reduced the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, by filing an amended return for the affected year within 180 days after the date that the foreign tax redetermination occurred. The IRS and the Treasury Department received several comments with respect to such rule suggesting that, in lieu of filing an amended return, taxpayers that are under continuous examination in a program such as the Coordinated Examination Program should be permitted to provide notice of foreign tax redeterminations to the examiner during an examination.

Taking into account these comments, the new temporary regulations at §1.905–4T(b)(3) provide that, where a redetermination of United States tax liability is required by reason of a foreign tax redetermination that occurs while a taxpayer is under the jurisdiction of the Large and Mid-Size Business Division and that results in a reduction in the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, the taxpayer must provide notice of such redetermination as part of the examination process in lieu of filing an amended return for the affected year as otherwise required by §1.905–4T(b)(1)(i) and (ii). If the taxpayer is required under §1.905–4T(b)(3) to provide notice as part of the examination process, the taxpayer must satisfy the requirements of §1.905–4T(b)(3) (in lieu of the generally applicable rules of §1.905–4T(b)(1)(i) or (ii)) in order not to be subject to the penalty under section 6689 and the regulations under that section.

Section 1.905–4T(b)(3) of the new regulations requires a taxpayer to notify the IRS of the foreign tax redetermination by providing to the examiner a statement described in §1.905–4T(c) during an examination of the return for the taxable year for which a redetermination of United States tax liability is required by reason of the foreign tax redetermination. The taxpayer must provide the statement to the examiner no later than 120 days after the latest of the date the foreign tax redetermination occurs, the opening conference, or the hand-delivery or postmark date of the opening letter concerning the examination. If, however, the foreign tax redetermination occurs more than 180 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter, the taxpayer may, in lieu of applying the rules of §1.905–4T(b)(1)(i) and (ii), provide to the examiner a statement which complies with the requirements of §1.905–4T(b)(3), and the IRS, in its discretion, may accept such statement or require the taxpayer to comply with the rules of §1.905–4T(b)(1)(i) and (ii).

This exception in §1.905–4T(b)(3) to the generally applicable notification requirements of §1.905–4T(b)(1) is not permitted to extend the length of the notification period set forth in §1.905–4T(b)(1). In addition, no notification under §1.905–4T(b)(3) will be due before May 5, 2008.

V. *Notification contents*

Section 1.905–4T(c)(1) of the new temporary regulations requires the taxpayer to furnish a statement that contains information sufficient for the IRS to redetermine the taxpayer's United States tax liability where such a redetermination is required under section 905(c). The taxpayer must provide such information in a form that enables the IRS to verify and compare the original computations of the claimed foreign tax credit, the revised computations resulting from the foreign tax redetermination, and the net changes resulting therefrom. The statement must include the taxpayer's name, address, identifying number, and the taxable year or years of the taxpayer that are affected by the foreign tax redetermination. If the written statement is submitted to the IRS under §1.905–4T(b)(3), which provides rules with respect to taxpayers under the jurisdiction of the Large and Mid-Size Business Division, the statement must also include a declaration under penalties of perjury.

Where a redetermination of United States tax liability is required by reason of a foreign tax redetermination, new §1.905–4T(c)(2) requires that the taxpayer provide, in addition to the information described in new §1.905–4T(c)(1), specific information concerning the foreign tax redetermination. To take into account the amendment of section 986(a) (concerning translation rates for foreign taxes) by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004, the

new temporary regulations require the taxpayer to provide the exchange rates used to translate the amount of foreign taxes paid, accrued, or refunded in accordance with §1.905–3T(b) (as the case may be). These new temporary regulations also include the requirement of the 1988 temporary regulations that taxpayers provide information relating to the interest paid by foreign governments or owing to the United States due to a foreign tax redetermination.

If, as a result of a redetermination of foreign tax paid or accrued by a foreign corporation, adjustments to the pools of post-1986 undistributed earnings and post-1986 foreign income taxes are required under §1.905–3T(d)(2) of the 1988 temporary regulations in lieu of a redetermination of a domestic corporate shareholder's United States tax liability, §1.905–3T(d)(2)(iii) of the 1988 temporary regulations requires that the taxpayer provide certain information concerning the foreign tax redetermination and the pooling adjustments. In order to reduce the notification requirement burden, the new temporary regulations modify this reporting requirement, as discussed above in section IV.C., "Special Rules for Certain Redeterminations." If, as a result of a redetermination of foreign tax paid or accrued by a foreign corporation, a redetermination of United States tax liability is required under new §1.905–3T(d)(3) in lieu of a pooling adjustment, the new temporary regulations at §1.905–4T(c)(3) specify the information that the taxpayer must provide.

VI. *Payment or refund of United States tax, and application of interest and penalties*

Section 1.905–4T(d) of the new temporary regulations adopts without amendment that portion of the 1988 temporary regulations at §1.905–4T(b)(1) which provides that the amount of tax, if any, due upon a redetermination of United States tax liability will be paid by the taxpayer after notice and demand has been made by the IRS. The regulation also clarifies that deficiency procedures under Subchapter B of chapter 63 of the Internal Revenue Code will not apply with respect to the assessment of the amount due upon such redetermination, meaning that the IRS is not required to send a statutory notice of deficiency to a taxpayer, and the taxpayer does not have an opportunity to petition the Tax Court, prior to the IRS' assessment and collection of the amount of additional tax due. In accordance with sections 905(c) and 6501(c)(5), the statute of limitations under section 6501(a) will not apply to the assessment and collection of the amount of additional tax due. The amount of tax, if any, shown by a redetermination of United States tax liability to have been overpaid will be credited or refunded to the taxpayer in accordance with section 6511(d)(3)(A) and the provisions of §301.6511(d)–3. Accordingly, the taxpayer must file a claim for credit or refund within ten years from the last date (without extensions) prescribed for filing the return for the taxable year in which the foreign taxes were actually paid or accrued.

Similarly, §1.905–4T(e) of the new temporary regulations adopts without amendment the interest and penalties provisions of the 1988 temporary regulations at §1.905–4T(c). First, new §1.905–4T(e)(1) provides that interest on the underpayment or overpayment resulting from a redetermination of United States tax liability will be computed in accordance with sections 6601 and 6611 and the regulations under those sections. No interest will be assessed or collected on any underpayment resulting from a refund of foreign tax for any period before the receipt of the refund, except to the extent interest was paid by the foreign country or possession of the United States on the refund for the period. In no case, however, will interest assessed and collected pursuant to the preceding sentence for any period before receipt of the refund exceed the amount that otherwise would have been assessed and collected under section 6601 and the regulations under that section for that period. Interest will be assessed from the time the taxpayer (or the foreign corporation of which the taxpayer is a shareholder) receives a foreign tax refund until the taxpayer pays the additional tax due the United States.

Second, new §1.905–4T(e)(2) provides that, if an adjustment to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes under §1.905–3T(d)(2) is required in lieu of a redetermination of United States tax liability, no underpayment or overpayment of United States tax liability will result from a foreign tax redetermination. Consequently, no interest will be paid by or to a taxpayer as a result of adjustments to a foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes where required under §1.905–3T(d)(2).

Third, §1.905–4T(e)(3) of the new temporary regulations provides that failure to comply with the provisions of §1.905–4T of the new temporary regulations will subject the taxpayer to the penalty provisions of section 6689 and the regulations under that section.

VII. *Foreign tax redeterminations with respect to pre-1987 accumulated profits*

Section 1.905–5T of the 1988 regulations provides rules relating to foreign tax redeterminations occurring in pre-1987 taxable years, and those occurring in post-1986 taxable years with respect to pre-1987 accumulated profits. The new temporary regulations amend the cross-references to §§1.905–3T and 1.905–4T and clarify that these rules apply to foreign tax redeterminations with respect to pre-1987 accumulated profits that are accumulated in taxable years of a foreign corporation beginning after December 31, 1986, but before the first taxable year in which the ownership requirements of section 902 are met. See §1.902–1(a)(10)(i).

VIII. *Penalty under section 6689*

Under section 6689, a taxpayer that fails to notify the IRS of a foreign tax redetermination in the time and manner prescribed by regulations for giving such notice is subject to a penalty unless it is shown that such failure is due to reasonable cause and not due to willful neglect. Section 6689(a) provides that the penalty is calculated by adding to the deficiency attributable to the foreign tax redetermination an amount equal to 5 percent of the deficiency if the failure is for not more than 1 month, plus an additional 5 percent of the deficiency for each month (or fraction thereof) during which the failure continues. The total amount of the penalty is not to exceed 25 percent of the deficiency.

Section 301.6689–1T(a) has been revised to clarify that deficiency proceed-

ings under Subchapter B of chapter 63 of the Code will not apply with respect to the amount of such penalty, meaning that the IRS is not required to send a statutory notice of deficiency to a taxpayer, and the taxpayer does not have an opportunity to petition the Tax Court, prior to the IRS' assessment and collection of the amount of such penalty.

Comments were received suggesting that, in computing the amount of the penalty, an overpayment resulting from one foreign tax redetermination should offset an underpayment resulting from another foreign tax redetermination where both foreign tax redeterminations arise from the same foreign taxing jurisdiction and require a redetermination of United States tax liability for the same taxable year. Thus, the commentators suggested, where the underpayment is completely offset by one or more overpayments, the section 6689 penalty should not apply. Because the penalty is determined with respect to a deficiency attributable to such redetermination, there must be some deficiency for the penalty to apply. Where underpayments and overpayments offset each other to reduce or eliminate a deficiency, any penalty under section 6689 would also be reduced or eliminated. The IRS and Treasury Department do not believe an amendment to the regulations is necessary to clarify this rule.

Another comment was received suggesting that the section 6689 penalty generally should be inapplicable to Coordinated Exam Program taxpayers, provided that a notice of foreign tax redeterminations is submitted by the taxpayer at the commencement of the audit. Such a suggestion is generally adopted at §1.905–4T(b)(3). A further comment requested that the definition of reasonable care under the regulations be revised. The 1988 regulations provide that, if a taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the notification within the prescribed time, then the delay will be considered to be due to reasonable cause and not willful neglect. The comment recommended instead adopting a more objective test based on substantial compliance. This comment is rejected because ordinary business care and prudence is the general standard for reasonable care that is used in the regulations for other penalties.

Effective/applicability date

The new temporary regulations of §§1.905–3T(c) and (d) and 1.905–4T are generally applicable for foreign tax redeterminations occurring in taxable years of United States taxpayers beginning on or after November 7, 2007, where the redetermination affects the amount of foreign taxes paid or accrued by a United States taxpayer. Where the redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960 with respect to post-1986 undistributed earnings (or pre-1987 accumulated profits) of the foreign corporation, the new temporary regulations of §§1.905–3T(c) and (d), 1.905–4T, and 1.905–5T are generally effective for foreign tax redeterminations occurring in taxable years of a foreign corporation which end with or within a taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. See §1.905–4T(f)(1). In no case, however, will §1.905–4T(f) operate to extend the statute of limitations provided by section 6511(d)(3)(A).

Section 1.905–3T(b), which provides rules with respect to currency translation, generally is applicable for taxes paid or accrued in taxable years of United States taxpayers beginning on or after November 7, 2007, and to taxes paid or accrued by a foreign corporation in its taxable years which end with or within a taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. For taxable years beginning after December 31, 1997, and before November 7, 2007, section 986(a), as amended by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004, shall apply. For taxable years beginning after December 31, 1986, and prior to the effective date of the Taxpayer Relief Act of 1997 (January 1, 1998), §1.905–3T of the 1988 temporary regulations shall apply.

Section 1.905–3T(b)(1)(ii)(D), which provides taxpayers otherwise required to translate foreign income taxes using the average exchange rate an election to translate taxes using the exchange rate for the date of payment, is applicable for taxable years beginning on or after November 7, 2007. For taxable years beginning after December 31, 2004, and before November 7, 2007, the rules of Notice 2006–47, 2006–1 C.B 892 (see §601.601(d)(2)(ii)(*b*)), shall apply.

Although all foreign tax redeterminations occurring in taxable years beginning after December 31, 1986, are subject to the requirements of section 905(c) and the regulations under that section, the 1988 temporary regulations did not specify the date by which the required notifications must be made in order to avoid a penalty under section 6689. The IRS and the Treasury Department recognize the burden associated with requiring notification by a specific date of all previously-unreported foreign tax redeterminations that require a United States tax redetermination with respect to post-1986 taxable years. Consequently, the new temporary regulations at §1.905–4T(f)(2) provide a specific due date only for notifications of foreign tax redeterminations that occurred in a taxpayer's three taxable years preceding the first taxable year identified in §1.905–4T(f)(1), and taxable years of foreign corporations ending with or within such taxable years of their domestic corporate shareholders. However, the unlimited statute of limitations under section 905(c) and deficiency interest provisions continue to apply to any underpayment of United States tax attributable to a foreign tax redetermination.

Section 1.905–4T(f)(2)(ii) provides notification requirements for any foreign tax redetermination which occurred in the last taxable year of a United States taxpayer beginning before November 7, 2007, and the two immediately preceding taxable years and which reduced the amount of foreign taxes paid or accrued by the taxpayer for any taxable year. This section also requires notification of any redetermination of foreign taxes paid or accrued by a foreign corporation which occurred in a taxable year of the foreign corporation which ends with or within a taxable year of a domestic corporate shareholder described in the preceding sentence and which requires a redetermination of United States tax liability under §1.905–3T(d)(3) for any taxable year. If, as of November 7, 2007, the taxpayer has not satisfied the notice requirements described in §§1.905–3T and 1.905–4T of the 1988 temporary regulations with respect to such foreign tax redeterminations, the new temporary regulations at

§1.905–4T(f)(2)(ii) generally require the taxpayer to notify the IRS of such foreign tax redetermination no later than the due date (with extensions) of its original return for the taxable year following the taxable year in which these regulations are first effective.

New §1.905–4T(f)(2)(ii) sets forth the time and manner of the notification, which must contain the previously-unreported information described in new §1.905–4T(c). The temporary regulations do not require notification of previously-unreported foreign tax redeterminations of a foreign corporation that occurred in taxable years of the foreign corporation that ended with or within a domestic corporate shareholder's taxable year beginning before November 7, 2007, if the foreign tax redetermination does not require a redetermination of United States tax liability but is accounted for by adjusting the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes.

New §1.905–4T(f)(2)(iii) provides that a taxpayer under the jurisdiction of the Large and Mid-Size Business Division that is otherwise required to file an amended return, Form 1118, and the statement required under §1.905–4T(c) as required in new §1.905–4T(f)(2)(ii) may, in lieu of applying §1.905–4T(f)(2)(ii), notify the IRS in the course of an examination of the return for the taxable year for which a redetermination of United States tax liability is required. In such case, the notification must contain the information described in new §1.905–4T(c) and must be provided within 120 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter concerning an examination of the return for the taxable year for which a redetermination of United States tax liability is required or May 5, 2008, whichever is later. However, if November 7, 2007, is more than 180 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter, the IRS, in its discretion, may accept such statement or require the taxpayer to comply with the rules of paragraph (f)(2)(ii) of this section. In addition, this exception to the notification requirements of §1.905–4T(f)(2)(ii) is not permitted to extend the length of the notification period set forth in §1.905–4T(f)(2)(ii). Therefore, §1.905–4T(f)(2)(iii) will not apply if the last day for providing notice of the foreign tax redetermination under §1.905–4T(f)(2)(ii) precedes the latest of the opening conference or the hand-delivery or postmark date of the opening letter concerning an examination of the return for the taxable year for which a redetermination of United States tax liability is required.

Section 1.905–4T(f)(2)(iv) provides that interest will be computed in accordance with §1.905–4T(e), and that the taxpayer must satisfy the requirements of §1.905–4T(f)(2) in order not to be subject to the penalty provisions of section 6689 and the regulations under that section.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble of the cross-referenced notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Teresa Burridge Hughes of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.905–3T is amended as follows:

1. Revise the section heading and paragraphs (a), (b)(1), (b)(2), (b)(3), (b)(5), (c), and (d)(2)(i).
2. Revise the second and third sentences in paragraph (d)(1).
3. Remove paragraphs (d)(2)(ii), (d)(2)(iii), (d)(2)(iv), the heading for paragraph (d)(3), and paragraph (d)(3)(i).
4. Redesignate paragraphs (d)(3), (d)(3)(ii), (d)(3)(iii), (d)(3)(iv), and (d)(3)(v) as paragraph (d)(2)(ii), (d)(2)(ii)(A), (d)(2)(ii)(B), (d)(2)(ii)(C), and (d)(2)(ii)(D), respectively.
5. Add a new paragraph heading to newly-designated paragraph (d)(2)(ii).
6. Revise newly-designated paragraphs (d)(2)(ii)(A), (d)(2)(ii)(B), and (d)(2)(ii)(D).
7. Remove the language "(d)(3)(iv)" from the second to last sentence of newly-designated paragraph (d)(2)(ii)(C) and add the language "(d)(2)(ii)(C)" in its place. Remove the language "§1.905–3T(d)(4)(iv)" from the last sentence of newly-designated paragraph (d)(2)(ii)(C) and add the language "paragraph (d)(3)(iv) of this section" in its place.
8. Redesignate paragraph (d)(4) as paragraph (d)(3).
9. Remove the language "(d)(4)" from newly-designated paragraph (d)(3) and add the language "(d)(3)" in its place.
10. Revise newly-designated paragraphs (d)(3)(ii), (d)(3)(iii), and (d)(3)(v).
11. Redesignate paragraph (f) as paragraph (d)(3)(vi).
12. Add a new paragraph (f).

The revisions and additions read as follows:

§1.905–3T Adjustments to United States tax liability and to the pools of post-1986 undistributed earnings and post-1986 foreign income taxes as a result of a foreign tax redetermination (temporary).

(a) *Effective/applicability dates*—(1) *Currency translation.* Except as provided in §1.905–5T, paragraph (b) of this section applies to taxes paid or accrued in

taxable years of United States taxpayers beginning on or after November 7, 2007 and to taxes paid or accrued by a foreign corporation in its taxable years which end with or within a taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. For taxable years beginning after December 31, 1997, and before November 7, 2007, section 986(a), as amended by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004, shall apply. For taxable years beginning after December 31, 1986, and before January 1, 1998, §1.905–3T (as contained in 26 CFR part 1, revised as of April 1, 2007) shall apply.

(2) *Foreign tax redeterminations*. Paragraphs (c) and (d) of this section apply to foreign tax redeterminations occurring in taxable years of United States taxpayers beginning on or after November 7, 2007, where the foreign tax redetermination affects the amount of foreign taxes paid or accrued by a United States taxpayer. Where the redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960 with respect to post-1986 undistributed earnings of the foreign corporation, paragraphs (c) and (d) of this section apply to foreign tax redeterminations occurring in taxable years of a foreign corporation which end with or within a taxable year of the domestic corporate shareholder beginning on or after November 7, 2007. For corresponding rules applicable to foreign tax redeterminations occurring in taxable years beginning before November 7, 2007, see §§1.905–3T and 1.905–5T (as contained in 26 CFR part 1, revised as of April 1, 2007).

(b) *Currency translation rules*—(1) *Translation of foreign taxes taken into account when accrued*—(i) *In general*. Except as provided in paragraph (b)(1)(ii) of this section, in the case of a taxpayer or a member of a qualified group (as defined in section 902(b)(2)) that takes foreign income taxes into account when accrued, the amount of any foreign taxes denominated in foreign currency that have been paid or accrued, additional tax liability denominated in foreign currency, taxes withheld in foreign currency, or estimated taxes paid in foreign currency shall be translated into dollars using the average exchange rate (as defined in §1.989(b)–1) for the United States taxable year to which such taxes relate.

(ii) *Exceptions*—(A) *Taxes not paid within two years*. Any foreign income taxes denominated in foreign currency that are paid more than two years after the close of the United States taxable year to which they relate shall be translated into dollars using the exchange rate as of the date of payment of the foreign taxes. To the extent any accrued foreign income taxes denominated in foreign currency remain unpaid two years after the close of the taxable year to which they relate, see paragraph (b)(3) of this section for translation rules for the required adjustments.

(B) *Taxes paid before taxable year begins*. Any foreign income taxes paid before the beginning of the United States taxable year to which such taxes relate shall be translated into dollars using the exchange rate as of the date of payment of the foreign taxes.

(C) *Inflationary currency*. Any foreign income taxes the liability for which is denominated in any inflationary currency shall be translated into dollars using the exchange rate as of the date of payment of the foreign taxes. For this purpose, the term *inflationary currency* means the currency of a country in which there is cumulative inflation during the base period of at least 30 percent, as determined by reference to the consumer price index of the country listed in the monthly issues of International Financial Statistics, or a successor publication, of the International Monetary Fund. For purposes of this paragraph (b)(1)(ii)(C), *base period* means, with respect to any taxable year, the thirty-six calendar months immediately preceding the last day of such taxable year (see §1.985–1(b)(2)(ii)(D)). Accrued but unpaid taxes denominated in an inflationary currency shall be translated into dollars at the exchange rate on the last day of the United States taxable year to which such taxes relate.

(D) *Election to translate taxes using exchange rate for date of payment*. A taxpayer that is otherwise required to translate foreign income taxes that are denominated in foreign currency using the average exchange rate may elect to translate foreign income taxes described in this paragraph (b)(1)(ii)(D) into dollars using the exchange rate as of the date of payment of the foreign taxes, provided that the liability for such taxes is denominated in nonfunctional currency. A taxpayer may make an election under this paragraph (b)(1)(ii)(D) for all foreign income taxes, or for only those foreign income taxes that are denominated in nonfunctional currency and are attributable to qualified business units with United States dollar functional currencies. The election must be made by attaching a statement to the taxpayer's timely filed return (including extensions) for the first taxable year to which the election applies. The statement must identify whether the election is made for all foreign taxes or only for foreign taxes attributable to qualified business units with United States dollar functional currencies. Once made, the election shall apply for the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Commissioner. Accrued but unpaid taxes subject to an election under this paragraph (b)(1)(ii)(D) shall be translated into dollars at the exchange rate on the last day of the United States taxable year to which such taxes relate. For taxable years beginning after December 31, 2004, and before November 7, 2007, the rules of Notice 2006–47, 2006–1 C.B 892 (see §601.601(d)(2)(ii)(*b*)), shall apply.

(E) *Regulated investment companies*. In the case of a regulated investment company (as defined in section 851 and the regulations under that section) which takes into account income on an accrual basis, foreign income taxes paid or accrued with respect to such income shall be translated into dollars using the exchange rate as of the date the income accrues.

(2) *Translation of foreign taxes taken into account when paid*. In the case of a taxpayer that takes foreign income taxes into account when paid, the amount of any foreign tax liability denominated in foreign currency, additional tax liability denominated in foreign currency, or estimated taxes paid in foreign currency shall be translated into dollars using the exchange rate as of the date of payment of such foreign taxes. Foreign taxes withheld in foreign currency shall be translated into dollars using the exchange rate as of the date on which such taxes were withheld.

(3) *Refunds or other reductions of foreign tax liability*. In the case of a taxpayer that takes foreign income taxes into account when accrued, a reduction in the amount of previously-accrued foreign

taxes that is attributable to a refund of foreign taxes denominated in foreign currency, a credit allowed in lieu of a refund, the correction of an overaccrual, or an adjustment on account of accrued taxes denominated in foreign currency that were not paid by the date two years after the close of the taxable year to which such taxes relate, shall be translated into dollars using the exchange rate that was used to translate such amount when originally claimed as a credit or added to post-1986 foreign income taxes. In the case of foreign income taxes taken into account when accrued but translated into dollars on the date of payment, see paragraph (d) of this section for required adjustments to reflect a reduction in the amount of previously-accrued foreign taxes that is attributable to a difference in exchange rates between the date of accrual and date of payment. In the case of a taxpayer that takes foreign income taxes into account when paid, a refund or other reduction in the amount of foreign taxes denominated in foreign currency shall be translated into dollars using the exchange rate that was used to translate such amount when originally claimed as a credit. If a refund or other reduction of foreign taxes relates to foreign taxes paid or accrued on more than one date, then the refund or other reduction shall be deemed to be derived from, and shall reduce, the last payment of foreign taxes first, to the extent of that payment. See paragraphs (d)(1) (redetermination of United States tax liability for foreign taxes paid directly by a United States person) and (d)(2)(ii) (method of adjustment of a foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes) of this section.

* * * * *

(5) *Basis of foreign currency refunded*—(i) *In general*. A recipient of a refund of foreign tax shall determine its basis in the currency refunded under the following rules.

(ii) *United States dollar functional currency*. If the functional currency of the qualified business unit (QBU) (as defined in section 989 and the regulations under that section) that paid the tax and received the refund is the United States dollar or the person receiving the refund is not a QBU, then the recipient's basis in the foreign currency refunded shall be the dollar value of the refund determined under paragraph (b)(3) of this section by using, as appropriate, either the average exchange rate for the taxable year to which such taxes relate or the other exchange rate that was used to translate such amount when originally claimed as a credit or added to post-1986 foreign income taxes.

(iii) *Nondollar functional currency*. If the functional currency of the QBU receiving the refund is not the United States dollar and is different from the currency in which the foreign tax was paid, then the recipient's basis in the foreign currency refunded shall be equal to the functional currency value of the non-functional currency refund translated into functional currency at the exchange rate between the functional currency and the non-functional currency. Such exchange rate is determined under paragraph (b)(3) of this section by substituting the words "functional currency" for the word "dollar" and by using, as appropriate, either the average exchange rate for the taxable year to which such taxes relate or the other exchange rate that was used to translate such amount when originally claimed as a credit or added to post-1986 foreign income taxes.

(iv) *Functional currency tax liabilities*. If the functional currency of the QBU receiving the refund is the currency in which the refund was made, then the recipient's basis in the currency received shall be the amount of the functional currency received.

(v) *Foreign currency gain or loss*. For purposes of determining foreign currency gain or loss on the initial payment of accrued foreign tax in a non-functional currency, see section 988. For purposes of determining subsequent foreign currency gain or loss on the disposition of non-functional currency the basis of which is determined under this paragraph (b)(5), see section 988(c)(1)(C).

(c) *Foreign tax redetermination*. For purposes of this section and §1.905–4T, the term *foreign tax redetermination* means a change in the foreign tax liability that may affect a taxpayer's foreign tax credit. A foreign tax redetermination includes: accrued taxes that when paid differ from the amounts added to post-1986 foreign income taxes or claimed as credits by the taxpayer (such as corrections to overaccruals and additional payments); accrued taxes that are not paid before the date two years after the close of the taxable year to which such taxes relate; any tax paid that is refunded in whole or in part; and, for taxes taken into account when accrued but translated into dollars on the date of payment, a difference between the dollar value of the accrued tax and the dollar value of the tax paid attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment.

(d) * * * (1) * * * See §1.905–4T(b) which requires notification to the IRS of a foreign tax redetermination with respect to which a redetermination of United States liability is required, and see section 905(b) and the regulations under that section which require that a taxpayer substantiate that a foreign tax was paid and provide all necessary information establishing its entitlement to the foreign tax credit. However, a redetermination of United States tax liability is not required (and a taxpayer need not notify the IRS) if the foreign taxes are taken into account when accrued but translated into dollars as of the date of payment, the difference between the dollar value of the accrued tax and the dollar value of the tax paid is attributable to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment, and the amount of the foreign tax redetermination with respect to each foreign country is less than the lesser of ten thousand dollars or two percent of the total dollar amount of the foreign tax initially accrued with respect to that foreign country for the United States taxable year. * * *

(2) *Foreign taxes deemed paid under sections 902 or 960*—(i) *Redetermination of United States tax liability not required*. Subject to the special rule of paragraph (d)(3) of this section, a redetermination of United States tax liability is not required to account for the effect of a redetermination of foreign tax paid or accrued by a foreign corporation on the foreign taxes deemed paid by a United States corporation under section 902 or 960. Instead, appropriate upward or downward adjustments shall be made, in accordance with paragraph (d)(2)(ii) of this section, at the time of the foreign tax redetermination to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes to reflect the effect of

the foreign tax redetermination in calculating foreign taxes deemed paid with respect to distributions and inclusions (and the amount of such distributions and inclusions) that are includible in the United States taxable year in which the foreign tax redetermination occurred and subsequent taxable years. See §1.905–4T(b)(2) for notification requirements where a redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960, and the taxpayer is required to adjust the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes under this paragraph (d)(2).

(ii) *Adjustments to the pools of post-1986 undistributed earnings and post-1986 foreign income taxes*—(A) *Reduction in foreign tax paid or accrued.* A foreign corporation's pool of post-1986 foreign income taxes in the appropriate separate category shall be reduced by the United States dollar amount of a foreign tax refund or other reduction in the amount of foreign tax paid or accrued, translated into United States dollars as provided in paragraph (b)(3) of this section. A foreign corporation's pool of post-1986 undistributed earnings in the appropriate separate category shall be increased by the functional currency amount of the foreign tax refund or other reduction in the amount of foreign tax paid or accrued. The allocation of the refund or other adjustment to the appropriate separate categories shall be made in accordance with paragraph (b)(4) of this section and §1.904–6. If a foreign corporation receives a refund of foreign tax in a currency other than its functional currency, that refund shall be translated into its functional currency, for purposes of computing the increase to its pool of post-1986 undistributed earnings, at the exchange rate between the functional currency and the non-functional currency, as determined under paragraph (b)(3) of this section, by substituting the words "functional currency" for the word "dollar" and by using the same average or spot rate exchange rate convention that applies for purposes of translating such foreign taxes into United States dollars.

(B) *Additional foreign tax paid or accrued.* A foreign corporation's pool of post-1986 foreign income taxes in the appropriate separate category shall be increased by the United States dollar amount of the additional foreign tax paid or accrued, translated in accordance with the rules of paragraphs (b)(1) and (b)(2) of this section. A foreign corporation's pool of post-1986 undistributed earnings in the appropriate separate category shall be decreased by the functional currency amount of the additional foreign tax paid or accrued. The allocation of the additional amount of foreign tax among the separate categories shall be made in accordance with §1.904–6. If a foreign corporation pays or accrues foreign tax in a currency other than its functional currency, that tax shall be translated into its functional currency, for purposes of computing the decrease to its pool of post-1986 undistributed earnings, at the exchange rate between the functional currency and the non-functional currency, as determined under paragraph (b)(3) of this section, by substituting the words "functional currency" for the word "dollar" and by using the same average or spot rate exchange rate convention that applies for purposes of translating such foreign taxes into United States dollars.

* * * * *

(D) *Examples.* The following examples illustrate the application of this paragraph (d)(2):

Example 1. Controlled foreign corporation (CFC) is a wholly-owned subsidiary of its domestic parent, P. Both CFC and P are calendar year taxpayers. CFC has a functional currency, the u, other than the dollar and its pool of post-1986 undistributed earnings is maintained in that currency. CFC and P use the average exchange rate to translate foreign taxes. In 2008, CFC accrued and paid 100u of foreign income taxes with respect to non-subpart F income. The average exchange rate for 2008 was \$1:1u. In 2009, CFC received a refund of 50u of foreign taxes with respect to its non-subpart F income in 2008. CFC made no distributions to P in 2008. In accordance with paragraph (d)(2)(ii)(A) of this section and subject to paragraph (d)(3) of this section, in 2009 CFC's pool of post-1986 foreign income taxes must be reduced by \$50 (because the refund must be translated into dollars using the exchange rate that was used to translate such amount when added to CFC's post-1986 foreign income taxes, that is, \$1:1u, the average exchange rate for 2008) and the CFC's pool of post-1986 undistributed earnings must be increased by 50u (because the post-1986 undistributed earnings must be increased by the functional currency amount of the refund received). An income adjustment reflecting foreign currency gain or loss under section 988 with respect to the refund of foreign taxes received by CFC is not required because the foreign taxes are denominated and paid in CFC's functional currency.

Example 2. The facts are the same as in *Example 1*, except that in 2008, CFC had general category post-1986 undistributed earnings attributable to non-subpart F income of 200u (net of foreign taxes), and CFC accrued and paid 160u in foreign income taxes with respect to those earnings. The average exchange rate for 2008 was \$1:1u. Also in 2008, CFC made a distribution to P of 50u, and P was deemed to have paid \$40 of foreign taxes with respect to that distribution (50u/200u x \$160). In 2009, CFC received a refund of foreign taxes of 5u with respect to its non-subpart F income in 2008. Also in 2009, CFC made a distribution to P of 50u. CFC had no income and paid no foreign taxes in 2009. In accordance with paragraph (d)(2)(ii) of this section, CFC's pool of general category post-1986 foreign income taxes is reduced in 2009 by \$5 to \$115 (because the refund must be translated into dollars using the exchange rate that was used to translate such amount when added to CFC's post-1986 foreign income taxes, that is, \$1:1u, the average exchange rate for 2008), and CFC's pool of general category post-1986 undistributed earnings must be increased in 2009 by 5u to 155u (because the post-1986 undistributed earnings must be increased by the functional currency amount of the refund received). (An income adjustment reflecting foreign currency gain or loss under section 988 with respect to the refund of foreign taxes received by CFC is not required because the foreign taxes are denominated and paid in CFC's functional currency.) A redetermination of P's deemed paid credit and U.S. tax for 2008 is not required, because the 5u refund, if taken into account in 2008, would have reduced P's deemed paid taxes by less than 10% (50u/205u x \$155 = \$37.80). See paragraph (d)(3)(ii) of this section. P is deemed to pay \$37.10 of foreign taxes with respect to the distribution in 2009 of 50u (50u/155u x \$115).

Example 3. (i) CFC1 is a foreign corporation that is wholly-owned by P, a domestic corporation. CFC2 is a foreign corporation that is wholly-owned by CFC1. The functional currency of CFC1 and CFC2 is the u, and the pools of post-1986 undistributed earnings of CFC1 and CFC2 are maintained in that currency. CFC1, CFC2, and P use the average exchange rate to translate foreign income taxes. In 2008, CFC2 had post-1986 undistributed earnings attributable to non-subpart F income of 100u (net of foreign taxes) and paid 100u in foreign income taxes with respect to those earnings. The average exchange rate for 2008 was \$1:1u. CFC1 had no income and no earnings and profits other than those resulting from distributions from CFC2, as provided in either Situation 1 or Situation 2. CFC1 paid no foreign taxes.

(ii) *Situation 1.* In 2009, CFC2 received a refund of foreign taxes of 25u with respect to its 2008 taxable year. As of the close of 2009, CFC2 had 125u of post-1986 undistributed earnings (100u + 25u) and \$75 of post-1986 foreign income taxes (\$100 - \$25). In 2010, CFC2 made a distribution to CFC1 of 50u. CFC1 was deemed to have paid \$30 of foreign taxes with respect to that distribution (50u/125u x \$75). (An income adjustment reflecting foreign currency gain or loss under section 988 with respect to the refund of foreign taxes received by CFC1 is not required because the foreign taxes are denominated and paid in CFC1's functional currency.) At the end of 2010, CFC2 had 75u of post-1986 undistributed earn-

ings (125u - 50u) and $45 of post-1986 foreign income taxes ($75 - $30).

(iii) *Situation 2.* The facts are the same as in *Example 3(ii), Situation 1*, except that CFC2 made a distribution of 50u in 2009 and received a refund of 75u of foreign tax in 2010. In 2009, the amount of foreign taxes deemed paid by CFC1 is $50 (50u/100u x $100). In accordance with paragraph (d)(2)(ii)(C) of this section, the pools of post-1986 foreign income taxes of CFC1, as well as CFC2, must be adjusted in 2010, because the 2010 refund would otherwise have the effect of reducing below zero CFC2's pool of post-1986 foreign income taxes. Under paragraph (d)(3)(iv) of this section, the pools would have to be adjusted in 2009, and a redetermination of P's United States tax liability would be required, if P had received or accrued a distribution or inclusion from CFC1 or CFC2 in 2009 and computed an amount of foreign taxes deemed paid. CFC1's pool of post-1986 foreign income taxes must be reduced in 2010 by $42.86, determined as follows: $50 (foreign taxes deemed paid on the distribution from CFC2) minus $7.14 (the foreign taxes that would have been deemed paid had the refund occurred prior to the distribution (50u/175u x $25)). CFC2's pool of foreign taxes must be reduced in 2010 by $32.14, determined as follows: $75 (75u refund translated into dollars using the exchange rate that was used to translate such amount when originally added to post-1986 foreign income taxes, that is, $1:1u, the average exchange rate for 2008) minus $42.86 (the adjustment to CFC1's pool of post-1986 foreign income taxes). (An income adjustment reflecting foreign currency gain or loss under section 988 with respect to the refund of foreign taxes received by CFC1 is not required because the foreign taxes are denominated and paid in CFC1's functional currency.) The following reflects the pools of post-1986 undistributed earnings and post-1986 foreign income taxes of CFC1 and CFC2.

	Post-1986 Earnings (u)	Foreign taxes ($)
CFC2:		
2008	100	100
2009	100 - 50 = 50	100 - 50 = 50
2010	50 + 75 = 125	50 - 32.14 = 17.86
CFC1:		
2009	50	50
2010	50	50 - 42.86 = 7.14

* * * * *

(d)(3) * * *

(ii) *Deemed paid foreign tax adjustment of ten percent or more.* A redetermination of United States tax liability is required if a foreign tax redetermination occurs with respect to foreign taxes paid by a foreign corporation and such foreign tax redetermination, if taken into account in the taxable year of the foreign corporation to which the foreign tax redetermination relates, has the effect of reducing by ten percent or more the domestic corporate shareholder's foreign taxes deemed paid under section 902 or 960 with respect to a distribution or inclusion from the foreign corporation in any taxable year of the domestic corporate shareholder. If a redetermination of United States tax is required under the preceding sentence for any taxable year, a redetermination of United States tax is also required for all subsequent taxable years in which the domestic corporate shareholder received or accrued a distribution or inclusion from the foreign corporation.

(iii) *Example.* The following example illustrates the application of paragraph (d)(3)(ii) of this section:

Example. (i) *Facts.* Controlled foreign corporation (CFC) is a wholly-owned subsidiary of its domestic parent, P. Both CFC and P use the calendar year as their taxable year. CFC has a functional currency, the u, other than the dollar, and its pool of post-1986 undistributed earnings is maintained in that currency. CFC and P use the average exchange rate to translate foreign income taxes. As of January 1, 2008, CFC had 500u of general category post-1986 undistributed earnings and $200 of general category post-1986 foreign income taxes. In 2008, when the average exchange rate for the year was $1:1u, CFC earned general category income of 600u, accrued 100u of foreign income tax with respect to that income, and made a distribution to P of 100u, 10% of CFC's post-1986 undistributed earnings of 1,000u. P was deemed to have paid $30 of foreign income taxes in 2008 with respect to that distribution (100u/1,000u x $300). In 2009, CFC paid its actual foreign tax liability for 2007 of 80u. Also in 2009, for which the average exchange rate was $1:1.5u, CFC earned 500u of general category income, accrued 150u of tax with respect to that income, and distributed 100u to P. In 2010, CFC incurred a general category loss of (500u) and accrued no foreign tax. The loss was carried back to 2008 for foreign tax purposes, and CFC received a refund in 2011 of all 80u of foreign taxes paid for its 2008 taxable year.

(ii) *Result in 2009.* If the 20u overaccrual of tax for 2007 were taken into account in 2008, CFC's general category post-1986 undistributed earnings would be 1,020u, CFC's general category post-1986 foreign income taxes would be $280, and P would be deemed to pay $27.45 of tax with respect to the 2008 distribution of 100u (100u/1020u x $280 = $27.45). Because $2.55 is less than 10% of the $30 of foreign taxes deemed paid as originally calculated in 2008, P is not required to redetermine its deemed paid credit and U.S. tax liability for 2008 in 2009. Instead, CFC's general category post-1986 foreign income taxes are reduced by $20 in 2009 (because the overaccrual for 2008 is translated into dollars using the exchange rate that was used to translate such amount when originally added to post-1986 foreign income taxes, that is, $1:1u, the average exchange rate for 2008), and the corresponding pool of general category post-1986 undistributed earnings is increased by 20u in 2009 (because the post-1986 undistributed earnings pool is increased by the functional currency amount of the overaccrual). CFC's general category post-1986 undistributed earnings are also increased in 2009 to 1270u by the 350u earned in 2009 (900u + 20u + 350u = 1270u), and CFC's general category post-1986 foreign income taxes are increased by $100 to $350 ($270 - $20 + $100). P is deemed to pay $27.56 of foreign income taxes in 2009 with respect to the 100u distribution from CFC in that year (100u/1270u x $350).

(iii) *Result in 2011.* If the 80u refund of tax for 2008 were taken into account in 2008, CFC's general category post-1986 undistributed earnings would be 1,100u, CFC's general category post-1986 foreign income taxes would be $200, and P would be deemed to pay $18.18 of tax with respect to the 2008 distribution of 100u (100u/1,100u x $200 = $18.18). Because $11.82 is more than 10% of the $30 of foreign taxes deemed paid as originally calculated in 2008, under paragraph (d)(3)(ii) of this section, P is required to redetermine its deemed paid credit and U.S. tax liability for 2008 and 2009 in 2011. As redetermined in 2011, CFC's post-1986 undistributed earnings for 2009 are 1350u (1,100u as revised for 2008, less 100u distributed in 2008, plus 350u earned in 2009), and its post-1986 foreign income taxes for 2009 are $381.82 ($200 as revised for 2008, less $18.18 deemed paid in 2008, plus $100 accrued for 2009). As redetermined in 2011, P's deemed paid credit with respect to the 100u distribution from CFC in 2009 is $24.28 (100u/1350u x $381.82).

* * * * *

(v) *Example.* The following example illustrates the application of paragraph (d)(3)(iv) of this section:

Example. Controlled foreign corporation (CFC) is a wholly-owned subsidiary of its domestic parent, P. Both CFC and P are calendar year taxpayers. CFC has a functional currency, the u, other than the dollar, and its pool of post-1986 undistributed earnings is maintained in that currency. CFC and P use the

average exchange rate to translate foreign taxes. The average exchange rate for both 2008 and 2009 was $1:1u. In 2008, CFC earned 200u of general category income, accrued and paid 100u of foreign taxes with respect to that income, and made a distribution to P of 50u, half of CFC's post-1986 undistributed earnings of 100u. P is deemed to have paid $50 of foreign taxes with respect to that distribution (50u/100u x $100). In 2009, CFC received a refund of all 100u of foreign taxes related to the general category income for 2008. In 2009, CFC earned an additional 290u of income, 200u of which was passive category income and 90u of which was general category income, and accrued and paid 95u of foreign tax, 40u of which was with respect to the passive category income and 45u of which was with respect to the general category income. In accordance with paragraph (d)(3)(iv) of this section, P is required to redetermine its United States tax liability for 2008 to account for the foreign tax redetermination occurring in 2009 because, if an adjustment to CFC's pool of post-1986 foreign income taxes in the general category were made, the pool would be ($5). A deficit is not permitted to be carried in CFC's pool of post-1986 foreign income taxes in any separate category.

(f) *Expiration date.* The applicability of this section expires on or before November 5, 2010.

Par. 3. Section 1.905–4T is revised to read as follows:

§1.905–4T Notification of foreign tax redetermination (temporary).

(a) *Application of this section.* The rules of this section apply if, as a result of a foreign tax redetermination (as defined in §1.905–3T(c)), a redetermination of United States tax liability is required under section 905(c) and §1.905–3T(d).

(b) *Time and manner of notification*—(1) *Redetermination of United States tax liability*—(i) *In general.* Except as provided in paragraphs (b)(1)(iv), (v), and (b)(3) of this section, any taxpayer for which a redetermination of United States tax liability is required must notify the Internal Revenue Service (IRS) of the foreign tax redetermination by filing an amended return, Form 1118 (*Foreign Tax Credit — Corporations*) or Form 1116 (*Foreign Tax Credit*), and the statement required under paragraph (c) of this section for the taxable year with respect to which a redetermination of United States tax liability is required. Such notification must be filed within the time prescribed by this paragraph (b) and contain the information described in paragraph (c) of this section. Where a foreign tax redetermination requires an individual to redetermine the individual's United States tax liability, and as a result of such foreign tax redetermination the amount of creditable taxes paid or accrued by such individual during the taxable year does not exceed the applicable dollar limitation in section 904(k), the individual shall not be required to file Form 1116 with the amended return for such taxable year if the individual satisfies the requirements of section 904(k).

(ii) *Reduction in amount of foreign tax liability.* Except as provided in paragraphs (b)(1)(iv), (v), and (b)(3) of this section, for each taxable year of the taxpayer with respect to which a redetermination of United States tax liability is required by reason of a foreign tax redetermination that reduces the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, the taxpayer must file a separate notification for each such taxable year by the due date (with extensions) of the original return for the taxpayer's taxable year in which the foreign tax redetermination occurred.

(iii) *Increase in amount of foreign tax liability.* Except as provided in paragraphs (b)(1)(iv), (v), and (b)(3) of this section, for each taxable year of the taxpayer with respect to which a redetermination of United States tax liability is required by reason of a foreign tax redetermination that increases the amount of foreign taxes paid or accrued, or included in the computation of foreign taxes deemed paid, the taxpayer must notify the Internal Revenue Service within the period provided by section 6511(d)(3)(A). Filing of such notification within the prescribed period shall constitute a claim for refund of United States tax.

(iv) *Multiple redeterminations of United States tax liability for same taxable year.* Where more than one foreign tax redetermination requires a redetermination of United States tax liability for the same taxable year of the taxpayer and those redeterminations occur within two consecutive taxable years of the taxpayer, the taxpayer may file for such taxable year one amended return, Form 1118 or 1116, and the statement required under paragraph (c) of this section that reflect all such foreign tax redeterminations. If the taxpayer chooses to file one notification for such redeterminations, the taxpayer must file such notification by the due date (with extensions) of the original return for the taxpayer's taxable year in which the first foreign tax redetermination that reduces foreign tax liability occurred. Where a foreign tax redetermination with respect to the taxable year for which a redetermination of United States tax liability is required occurs after the date for providing such notification, more than one amended return may be required with respect to that taxable year.

(v) *Carryback and carryover of unused foreign tax.* Where a foreign tax redetermination requires a redetermination of United States tax liability that would otherwise result in an additional amount of United States tax due, but such amount is eliminated as a result of a carryback or carryover of an unused foreign tax under section 904(c), the taxpayer may, in lieu of applying the rules of paragraphs (b)(1)(i) and (ii) of this section, notify the IRS of such redetermination by attaching a statement to the original return for the taxpayer's taxable year in which the foreign tax redetermination occurs. Such statement must be filed by the due date (with extensions) of the original return for the taxpayer's taxable year in which the foreign tax redetermination occurred and contain the information described in §1.904–2(f).

(vi) *Example.* The following example illustrates the application of this paragraph (b)(1):

Example. (i) X, a domestic corporation, is an accrual basis taxpayer and uses the calendar year as its United States taxable year. X conducts business through a branch in Country M, the currency of which is the m, and also conducts business through a branch in Country N, the currency of which is the n. X uses the average exchange rate to translate foreign income taxes. Assume that X is able to claim a credit under section 901 for all foreign taxes paid or accrued.

(ii) In 2008, X accrued and paid 100m of Country M taxes with respect to 400m of foreign source general category income. The average exchange rate for 2008 was $1:1m. Also in 2008, X accrued and paid 50n of Country N taxes with respect to 150n of foreign source general category income. The average exchange rate for 2008 was $1:1n. X claimed a foreign tax credit of $150 ($100 (100m at $1:1m) + $50 (50n at $1:1n)) with respect to its foreign source general category income on its United States tax return for 2008.

(iii) In 2009, X accrued and paid 100n of Country N taxes with respect to 300n of foreign source general category income. The average exchange rate for 2009 was $1.50:1n. X claimed a foreign tax credit of $150 (100n at $1.5:1n) with respect to its foreign source general category income on its United States tax return for 2009.

(iv) On June 15, 2012, when the spot exchange rate was $1.40:1n, X received a refund of 10n from Country N, and, on March 15, 2013, when the spot

exchange rate was $1.20:1m, X was assessed by and paid Country M an additional 20m of tax. Both payments were with respect to X's foreign source general category income in 2008. On May 15, 2013, when the spot exchange rate was $1.45:1n, X received a refund of 5n from Country N with respect to its foreign source general category income in 2009.

(v) X must redetermine its United States tax liability for both 2008 and 2009. With respect to 2008, X must notify the IRS of the June 15, 2012, refund of 10n from Country N that reduced X's foreign tax liability by filing an amended return, Form 1118, and the statement required in paragraph (c) of this section for 2008 by the due date of the original return (with extensions) for 2012. The amended return and Form 1118 must reduce the amount of foreign taxes claimed as a credit under section 901 by $10 (10n refund translated at the average exchange rate for 2008, or $1:1n (see §1.905–3T(b)(3)). X will recognize foreign currency gain or loss under section 988 in or after 2012 on the conversion of the 10n refund into dollars. With respect to the March 15, 2013, additional assessment of 20m by Country M, X must notify the IRS within the time period provided by section 6511(d)(3)(A), increasing the foreign taxes available as a credit by $24 (20m translated at the exchange rate on the date of payment, or $1.20:1m). See sections 986(a)(1)(B)(i) and 986(a)(2)(A) and §1.905–3T(b)(1)(ii)(A). X may so notify the IRS by filing a second amended return, Form 1118, and the statement required in paragraph (c) of this section for 2008, within the time period provided by section 6511(d)(3)(A). Alternatively, when X redetermines its United States tax liability for 2008 to take into account the 10n refund from Country N which occurred in 2012, X may also take into account the 20m additional assessment by Country M which occurred on March 15, 2013. See §1.905–4T(b)(1)(iv). Where X reflects both foreign tax redeterminations on the same amended return, Form 1118, and in the statement required in paragraph (c) of this section for 2008, the amount of X's foreign taxes available as a credit would be:

(A) Reduced by $10 (10n refund translated at $1:1n) and

(B) Increased by $24 (20m additional assessment translated at the exchange rate on the date of payment, March 15, 2013, or $1.20:1m). The foreign taxes available as a credit therefore would be increased by $14 ($24 (additional assessment) - $10 (refund)). The due date of the 2008 amended return, Form 1118, and the statement required in paragraph (c) of this section reflecting foreign tax redeterminations in both years would be the due date (with extensions) of X's original return for 2012.

(vi) With respect to 2009, X must notify the IRS by filing an amended return, Form 1118, and the statement required in paragraph (c) of this section for 2009 that is separate from that filed for 2008. The amended return, Form 1118, and the statement required in paragraph (c) of this section for 2009 must be filed by the due date (with extensions) of X's original return for 2013. The amended return and Form 1118 must reduce the amount of foreign taxes claimed as a credit under section 901 by $7.50 (5n refund translated at the average exchange rate for 2009, or $1.50:1n). X will recognize foreign currency gain or loss under section 988 in or after 2013 on the conversion of the 5n refund into dollars.

(2) *Pooling adjustment in lieu of redetermination of United States tax liability.* Where a redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960, and the taxpayer is required to adjust the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes under §1.905–3T(d)(2), the taxpayer is required to notify the IRS of such redetermination by reflecting the adjustments to the foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes on a Form 1118 for the taxpayer's first taxable year with respect to which the redetermination affects the computation of foreign taxes deemed paid. Such Form 1118 must be filed by the due date (with extensions) of the original return for such taxable year. In the case of multiple redeterminations that affect the computation of foreign taxes deemed paid for the same taxable year and that are required to be reported under this paragraph (b)(2), a taxpayer may file one notification for all such redeterminations in lieu of filing a separate notification for each such redetermination. See section 905(b) and the regulations under that section which require that a taxpayer substantiate that a foreign tax was paid and provide all necessary information establishing its entitlement to the foreign tax credit.

(3) *Taxpayers under the jurisdiction of the Large and Mid-Size Business Division.* The rules of this paragraph (b)(3) apply where a redetermination of United States tax liability is required by reason of a foreign tax redetermination that results in a reduction in the amount of foreign taxes paid or accrued, or is included in the computation of foreign taxes deemed paid, and such foreign tax redetermination occurs while a taxpayer is under the jurisdiction of the Large and Mid-Size Business Division (or similar program). The taxpayer must, in lieu of applying the rules of paragraphs (b)(1)(i) and (ii) of this section (requiring the filing of an amended return, Form 1118, and a statement described in paragraph (c) of this section by the due date (with extensions) of the original return for the taxpayer's taxable year in which the foreign tax redetermination occurred), notify the IRS of such redetermination by providing to the examiner the statement described in paragraph (c) of this section during an examination of the return for the taxable year for which a redetermination of United States tax liability is required by reason of such foreign tax redetermination. The taxpayer must provide the statement to the examiner no later than 120 days after the latest of the date the foreign tax redetermination occurs, the opening conference of the examination, or the hand-delivery or postmark date of the opening letter concerning the examination. If, however, the foreign tax redetermination occurs more than 180 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter, the taxpayer may, in lieu of applying the rules of paragraphs (b)(1)(i) and (ii) of this section, provide the statement to the examiner within 120 days after the date the foreign tax redetermination occurs, and the IRS, in its discretion, may accept such statement or require the taxpayer to comply with the rules of paragraphs (b)(1)(i) and (ii) of this section. A taxpayer subject to the rules of this paragraph (b)(3) must satisfy the rules of this paragraph (b)(3) (in lieu of the rules of paragraphs (b)(1)(i) and (ii) of this section) in order not to be subject to the penalty relating to the failure to file notice of a foreign tax redetermination under section 6689 and the regulations under that section. This paragraph (b)(3) shall not apply where the due date specified in paragraph (b)(1)(ii) of this section for providing notice of the foreign tax redetermination precedes the latest of the opening conference or the hand-delivery or postmark date of the opening letter concerning an examination of the return for the taxable year for which a redetermination of United States tax liability is required by reason of such foreign tax redetermination. In addition, any statement that would otherwise be required to be provided under this paragraph (b)(3) on or before May 5, 2008, will be considered timely if provided on or before May 5, 2008.

(4) *Example.* The following example illustrates the application of paragraph (b)(3) of this section:

Example. X, a taxpayer under the jurisdiction of the Large and Mid-Size Business Division, uses the calendar year as its United States taxable year. On October 15, 2009, X receives a refund of foreign tax that constitutes a foreign tax redetermination that necessitates a redetermination of United States tax liability for X's 2008 taxable year. Under paragraph (b)(1)(ii) of this section, X is required to notify the IRS of the foreign tax redetermination by filing an

amended return, Form 1118, and the statement required in paragraph (c) of this section for its 2008 taxable year by September 15, 2010 (the due date (with extensions) of the original return for X's 2009 taxable year). On December 15, 2010, the IRS hand delivers an opening letter concerning the examination of the return for X's 2008 taxable year, and the opening conference for such examination is scheduled for January 15, 2011. Because the date for notifying the IRS of the foreign tax redetermination under paragraph (b)(1)(ii) of this section precedes the date of the opening conference concerning the examination of the return for X's 2008 taxable year, paragraph (b)(3) of this section does not apply, and X must notify the IRS of the foreign tax redetermination by filing an amended return, Form 1118, and the statement required in paragraph (c) of this section for the 2008 taxable year by September 15, 2010.

(c) *Notification contents*—(1) *In general.* In addition to satisfying the requirements of paragraph (b) of this section, the taxpayer must furnish a statement that contains information sufficient for the IRS to redetermine the taxpayer's United States tax liability where such a redetermination is required under section 905(c), and to verify adjustments to the pools of post-1986 undistributed earnings and post-1986 foreign income taxes where such adjustments are required under §1.905–3T(d)(2). The information must be in a form that enables the IRS to verify and compare the original computations with respect to a claimed foreign tax credit, the revised computations resulting from the foreign tax redetermination, and the net changes resulting therefrom. The statement must include the taxpayer's name, address, identifying number, and the taxable year or years of the taxpayer that are affected by the foreign tax redetermination. In addition, the taxpayer must provide the information described in paragraph (c)(2) or (c)(3) of this section, as appropriate. If the statement is submitted to the IRS under paragraph (b)(3) of this section, which provides requirements with respect to reporting by taxpayers under the jurisdiction of the Large and Mid-Size Business Division, the statement must also include the following declaration signed by a person authorized to sign the return of the taxpayer: "Under penalties of perjury, I declare that I have examined this written statement, and to the best of my knowledge and belief, this written statement is true, correct, and complete."

(2) *Foreign taxes paid or accrued.* Where a redetermination of United States tax liability is required by reason of a foreign tax redetermination as defined in §1.905–3T(c), in addition to the information described in paragraph (c)(1) of this section, the taxpayer must provide the following: the date or dates the foreign taxes were accrued, if applicable; the date or dates the foreign taxes were paid; the amount of foreign taxes paid or accrued on each date (in foreign currency) and the exchange rate used to translate each such amount, as provided in §1.905–3T(b)(1) or (b)(2); and information sufficient to determine any interest due from or owing to the taxpayer, including the amount of any interest paid by the foreign government to the taxpayer and the dates received. In addition, in the case of any foreign tax that is refunded in whole or in part, the taxpayer must provide the date of each such refund; the amount of such refund (in foreign currency); and the exchange rate that was used to translate such amount when originally claimed as a credit (as provided in §1.905–3T(b)(3)) and the exchange rate for the date the refund was received (for purposes of computing foreign currency gain or loss under section 988). In addition, in the case of any foreign taxes that were not paid before the date two years after the close of the taxable year to which such taxes relate, the taxpayer must provide the amount of such taxes in foreign currency, and the exchange rate that was used to translate such amount when originally added to post-1986 foreign income taxes or claimed as a credit. Where a redetermination of United States tax liability results in an amount of additional tax due, but the carryback or carryover of an unused foreign tax under section 904(c) only partially eliminates such amount, the taxpayer must also provide the information required in §1.904–2(f).

(3) *Foreign taxes deemed paid.* Where a redetermination of United States tax liability is required under §1.905–3T(d)(3) to account for the effect of a redetermination of foreign tax paid or accrued by a foreign corporation on foreign taxes deemed paid under section 902 or 960, in addition to the information described in paragraphs (c)(1) and (c)(2) of this section, the taxpayer must provide the balances of the pools of post-1986 undistributed earnings and post-1986 foreign income taxes before and after adjusting the pools in accordance with the rules of §1.905–3T(d)(2), the dates and amounts of any dividend distributions or other inclusions made out of earnings and profits for the affected year or years, and the amount of earnings and profits from which such dividends were paid for the affected year or years.

(d) *Payment or refund of United States tax.* The amount of tax, if any, due upon a redetermination of United States tax liability shall be paid by the taxpayer after notice and demand has been made by the IRS. Subchapter B of chapter 63 of the Internal Revenue Code (relating to deficiency procedures) shall not apply with respect to the assessment of the amount due upon such redetermination. In accordance with sections 905(c) and 6501(c)(5), the amount of additional tax due shall be assessed and collected without regard to the provisions of section 6501(a) (relating to limitations on assessment and collection). The amount of tax, if any, shown by a redetermination of United States tax liability to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 6511(d)(3)(A) and §301.6511(d)–3 of this chapter.

(e) *Interest and penalties*—(1) *In general.* If a redetermination of United States tax liability is required by reason of a foreign tax redetermination, interest shall be computed on the underpayment or overpayment in accordance with sections 6601 and 6611 and the regulations under these sections. No interest shall be assessed or collected on any underpayment resulting from a refund of foreign tax for any period before the receipt of the refund, except to the extent interest was paid by the foreign country or possession of the United States on the refund for the period. In no case, however, shall interest assessed and collected pursuant to the preceding sentence for any period before receipt of the foreign tax refund exceed the amount that otherwise would have been assessed and collected under section 6601 and the regulations under this section for that period. Interest shall be assessed from the time the taxpayer (or the foreign corporation of which the taxpayer is a shareholder) receives a refund until the taxpayer pays the additional tax due the United States.

(2) *Adjustments to pools of foreign taxes.* No underpayment or overpayment of United States tax liability results from a redetermination of foreign tax unless a redetermination of United States tax liability is required. Consequently, no interest

shall be paid by or to a taxpayer as a result of adjustments to a foreign corporation's pools of post-1986 undistributed earnings and post-1986 foreign income taxes made in accordance with §1.905–3T(d)(2).

(3) *Imposition of penalty.* Failure to comply with the provisions of this section shall subject the taxpayer to the penalty provisions of section 6689 and the regulations under that section.

(f) *Effective/applicability date*—(1) *In general.* This section applies to foreign tax redeterminations (defined in §1.905–3T(c)) occurring in taxable years of United States taxpayers beginning on or after November 7, 2007, where the foreign tax redetermination affects the amount of foreign taxes paid or accrued by a United States taxpayer. Where the redetermination of foreign tax paid or accrued by a foreign corporation affects the computation of foreign taxes deemed paid under section 902 or 960 with respect to pre-1987 accumulated profits or post-1986 undistributed earnings of the foreign corporation, this section applies to foreign tax redeterminations occurring in a taxable year of the foreign corporation which ends with or within a taxable year of its domestic corporate shareholder beginning on or after November 7, 2007. In no case, however, shall this paragraph (f)(1) operate to extend the statute of limitations provided by section 6511(d)(3)(A).

(2) *Foreign tax redeterminations occurring in taxable years beginning before November 7, 2007*—(i) *Scope.* This paragraph (f)(2) applies to any foreign tax redetermination (as defined in §1.905–3T(c)) which occurred in any of the three taxable years of a United States taxpayer immediately preceding the taxpayer's first taxable year beginning on or after November 7, 2007; reduced the amount of foreign taxes paid or accrued by the taxpayer; and requires a redetermination of United States tax liability for any taxable year. This paragraph (f)(2) also applies to any redetermination of foreign tax paid or accrued by a foreign corporation which occurred in a taxable year of the foreign corporation which ends with or within any of the three taxable years of a domestic corporate shareholder immediately preceding such shareholder's first taxable year beginning on or after November 7, 2007; reduced foreign taxes included in the computation of foreign taxes deemed paid by such shareholder under section 902 or 960; and requires a redetermination of United States tax liability under §1.905–3T(d)(3) for any taxable year. For corresponding rules applicable to foreign tax redeterminations occurring in taxable years beginning before the third taxable year immediately preceding the taxable year beginning on or after November 7, 2007, see 26 CFR §§1.905–4T and 1.905–5T (as contained in 26 CFR part 1, revised as of April 1, 2007).

(ii) *Notification required.* If, as of November 7, 2007, the taxpayer has not satisfied the notification requirements described in §1.905–3T and this section (as contained in 26 CFR part 1, revised as of April 1, 2007, as modified by Notice 90–26, 1990–1 C.B. 336, see §601.601(d)(2)(ii)(*b*) of this chapter), with respect to a foreign tax redetermination described in paragraph (f)(2)(i) of this section, the taxpayer must notify the IRS of the foreign tax redetermination by filing an amended return, Form 1118 or 1116, and the statement required in paragraph (c) of this section for the taxable year with respect to which a redetermination of United States tax liability is required. Such notification must be filed no later than the due date (with extensions) of the original return for the taxpayer's first taxable year following the taxable year in which these regulations are first effective. Where the foreign tax redetermination requires an individual to redetermine the individual's United States tax liability, and as a result of such foreign tax redetermination the amount of creditable taxes paid or accrued by such individual during the taxable year does not exceed the applicable dollar limitation in section 904(k), the individual shall not be required to file Form 1116 with the amended return for such taxable year if the individual satisfies the requirements of section 904(k). The rules of paragraphs (b)(1)(iv) and (v) of this section (concerning multiple redeterminations of United States tax liability for the same taxable year, and the carryback and carryover of unused foreign tax) shall apply.

(iii) *Taxpayers under the jurisdiction of the Large and Mid-Size Business Division.* If a taxpayer under the jurisdiction of the Large and Mid-Size Business Division is otherwise required under paragraph (f)(2)(ii) of this section to notify the IRS of a foreign tax redetermination described in paragraph (f)(2)(ii) of this section by filing an amended return, Form 1118, and the statement required in paragraph (c) of this section, such taxpayer may, in lieu of applying the rules of paragraph (f)(2)(ii) of this section, provide to the examiner the information described in paragraph (c) of this section during an examination of the return for the taxable year for which a redetermination of United States tax liability is required by reason of such foreign tax redetermination. The taxpayer must provide the information to the examiner on or before the date that is the later of May 5, 2008, or 120 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter concerning an examination of the return for the taxable year for which a redetermination of United States tax liability is required. However, if November 7, 2007, is more than 180 days after the latest of the opening conference or the hand-delivery or postmark date of the opening letter, the IRS, in its discretion, may accept such statement or require the taxpayer to comply with the rules of paragraph (f)(2)(ii) of this section. This paragraph (f)(2)(iii) shall not apply where the due date specified in paragraph (f)(2)(ii) of this section for providing notice of the foreign tax redetermination precedes the latest of the opening conference or the hand-delivery or postmark date of the opening letter concerning an examination of the return for the taxable year for which a redetermination of United States tax liability is required.

(iv) *Interest and penalties.* Interest shall be computed in accordance with paragraph (e) of this section. Failure to comply with the provisions of this paragraph (f)(2) shall subject the taxpayer to the penalty provisions of section 6689 and the regulations under that section.

(3) *Expiration date.* The applicability of this section expires on or before November 5, 2010.

Par. 4. Section 1.905–5T is amended as follows:

1. Remove the language "earnings and profits accumulated in taxable years of a foreign corporation beginning prior to January 1, 1987" from the second sentence of paragraph (a) and add the language "pre-1987 accumulated profits (as defined in §1.902–1(a)(10)(i)" in its place.

2. Remove the language "§1.905–4(b)(3)" from the second sentence of paragraph (d)(1) and add the language "§1.905–4T(c)" in its place.
3. Remove the language "§1.905–4T(b)(3)(ii)(A)" from paragraph (d)(2) and add the language "§1.905–4T(c)(2)" in its place.
4. Remove the language "paragraph (b)(3)(iii)" from paragraph (d)(3) and add the language "§1.905–4T(c)(3)" in its place.
5. Remove the language "§1.905–4T(b)(3)(iii) in lieu of the exchange rate for the date of the accrual" from paragraph (d)(4) and add the language "§1.905–4T(c)(3)" in its place.
6. Revise the heading and the first sentence of paragraph (f).
7. Add a new paragraph (g).

The revision and addition read as follows:

§1.905–5T Foreign tax redeterminations and currency translation rules for foreign tax redeterminations occurring in taxable years beginning prior to January 1, 1987 (temporary).

* * * * *

(f) *Special effective/applicability date.* See §1.905–4T(f) for the applicability date of notification requirements relating to foreign tax redeterminations that affect foreign taxes deemed paid under section 902 or section 960 with respect to pre-1987 accumulated profits accumulated in taxable years of a foreign corporation beginning on or after January 1, 1987. * * *

(g) *Expiration date.* The applicability of this section expires on or before November 5, 2010.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 5. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 6. Section 301.6689–1T is amended as follows:

1. Add a new sentence at the end of paragraph (a).
2. Revise paragraph (e).

The addition and revision read as follows:

§301.6689–1T Failure to file notice of redetermination of foreign tax (temporary).

(a) * * * Subchapter B of chapter 63 of the Internal Revenue Code (relating to deficiency proceedings) shall not apply with respect to the assessment of the amount of the penalty.

* * * * *

(e) *Effective/applicability date*—(1) *In general.* This section applies to foreign tax redeterminations (as defined in §1.905–3T(c) of this chapter) occurring in taxable years of United States taxpayers beginning on or after November 7, 2007, and in the three immediately preceding taxable years. For corresponding rules applicable to foreign tax redeterminations occurring in earlier taxable years of United States taxpayers, see §301.6689–1T (as contained in 26 CFR part 301, revised as of April 1, 2007).

(2) *Expiration date.* The applicability of this section expires on or before November 5, 2010.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved August 9, 2007.

Karen A. Sowell,
Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 7, 2007, 72 F.R. 62771)

Section 6689.—Failure to File Notice of Redetermination of Foreign Tax

These temporary regulations provide rules relating to the civil penalty imposed under section 6689 for failure to satisfy the notification requirements of section 905(c). The regulations also provide rules concerning section 905(c), which requires taxpayers to notify the IRS of a foreign tax redetermination, or a change in foreign tax liability that may affect the taxpayer's foreign tax credit. See T.D. 9362, page 1050.

These proposed regulations provide rules relating to the civil penalty imposed under section 6689 for failure to satisfy the notification requirements of section 905(c). The regulations also provide rules concerning section 905(c), which requires taxpayers to notify the IRS of a foreign tax redetermination, or a change in foreign tax liability that may affect the taxpayer's foreign tax credit. See REG-209020-86, page 1075.

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2007–91

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for October 2007 is 6.14 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted	Permissible Range		
Month	*Year*	Average	90%	to	100%
November	2007	5.89	5.30		5.89

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), section 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412 of the Code. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. For plan years beginning in 2008 and 2009, a transitional rule under § 430(h)(2)(G) provides that the segment rates are blended with the corporate bond weighted average as specified above. An election may be made under § 430(h)(2)(G)(iv) to use the segment rates without applying the transitional rule.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, the 24-month average corporate bond segment rates, and the funding transitional segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from October 2007 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of October 2007 are, respectively, 5.17, 6.02, and 6.38. The three 24-month average corporate bond segment rates applicable for November 2007 under the election of § 430(h)(2)(G)(iv) are as follows:

First Segment	Second Segment	Third Segment
5.31	5.88	6.40

The transitional segment rates under § 430(h)(2)(G) applicable for November 2007, taking into account the corporate bond weighted average of 5.89 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.70	5.89	6.06

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for October 2007 is 4.77 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in May 2037.

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) of the Code are segment rates computed without regard to a 24 month average. For plan years beginning in 2008 through 2011, the applicable interest rate is the monthly spot segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for October 2007, taking into account the October 2007 30-year Treasury rate of 4.77 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	4.85	5.02	5.09

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for October 2007

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	5.15	20.5	6.27	40.5	6.39	60.5	6.43	80.5	6.45
1.0	5.09	21.0	6.28	41.0	6.39	61.0	6.43	81.0	6.45
1.5	5.05	21.5	6.28	41.5	6.39	61.5	6.43	81.5	6.45
2.0	5.05	22.0	6.29	42.0	6.39	62.0	6.43	82.0	6.45
2.5	5.07	22.5	6.29	42.5	6.39	62.5	6.43	82.5	6.45
3.0	5.12	23.0	6.30	43.0	6.40	63.0	6.43	83.0	6.45
3.5	5.19	23.5	6.30	43.5	6.40	63.5	6.43	83.5	6.45
4.0	5.26	24.0	6.30	44.0	6.40	64.0	6.44	84.0	6.45
4.5	5.33	24.5	6.31	44.5	6.40	64.5	6.44	84.5	6.45
5.0	5.41	25.0	6.31	45.0	6.40	65.0	6.44	85.0	6.46
5.5	5.48	25.5	6.32	45.5	6.40	65.5	6.44	85.5	6.46
6.0	5.54	26.0	6.32	46.0	6.40	66.0	6.44	86.0	6.46
6.5	5.61	26.5	6.32	46.5	6.41	66.5	6.44	86.5	6.46
7.0	5.67	27.0	6.33	47.0	6.41	67.0	6.44	87.0	6.46
7.5	5.72	27.5	6.33	47.5	6.41	67.5	6.44	87.5	6.46
8.0	5.77	28.0	6.33	48.0	6.41	68.0	6.44	88.0	6.46
8.5	5.82	28.5	6.34	48.5	6.41	68.5	6.44	88.5	6.46
9.0	5.86	29.0	6.34	49.0	6.41	69.0	6.44	89.0	6.46
9.5	5.90	29.5	6.34	49.5	6.41	69.5	6.44	89.5	6.46
10.0	5.94	30.0	6.34	50.0	6.41	70.0	6.44	90.0	6.46
10.5	5.98	30.5	6.35	50.5	6.41	70.5	6.44	90.5	6.46
11.0	6.01	31.0	6.35	51.0	6.41	71.0	6.44	91.0	6.46
11.5	6.04	31.5	6.35	51.5	6.42	71.5	6.44	91.5	6.46
12.0	6.06	32.0	6.36	52.0	6.42	72.0	6.44	92.0	6.46
12.5	6.09	32.5	6.36	52.5	6.42	72.5	6.44	92.5	6.46
13.0	6.11	33.0	6.36	53.0	6.42	73.0	6.45	93.0	6.46
13.5	6.13	33.5	6.36	53.5	6.42	73.5	6.45	93.5	6.46
14.0	6.14	34.0	6.36	54.0	6.42	74.0	6.45	94.0	6.46
14.5	6.16	34.5	6.37	54.5	6.42	74.5	6.45	94.5	6.46
15.0	6.17	35.0	6.37	55.0	6.42	75.0	6.45	95.0	6.46
15.5	6.19	35.5	6.37	55.5	6.42	75.5	6.45	95.5	6.46
16.0	6.20	36.0	6.37	56.0	6.42	76.0	6.45	96.0	6.46
16.5	6.21	36.5	6.38	56.5	6.42	76.5	6.45	96.5	6.46
17.0	6.22	37.0	6.38	57.0	6.43	77.0	6.45	97.0	6.46
17.5	6.23	37.5	6.38	57.5	6.43	77.5	6.45	97.5	6.46
18.0	6.24	38.0	6.38	58.0	6.43	78.0	6.45	98.0	6.46
18.5	6.24	38.5	6.38	58.5	6.43	78.5	6.45	98.5	6.46
19.0	6.25	39.0	6.38	59.0	6.43	79.0	6.45	99.0	6.46
19.5	6.26	39.5	6.39	59.5	6.43	79.5	6.45	99.5	6.46
20.0	6.26	40.0	6.39	60.0	6.43	80.0	6.45	100.0	6.46

Interim Guidance Under Section 6404(g)

Notice 2007–93

PURPOSE

This notice describes how the amendment to section 6404(g) made by the Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110–028, § 8242, 121 Stat. 190, 200 (May 25, 2007), applies to notices under section 6404(g)(1) that are provided on or after November 26, 2007.

SCOPE

This notice applies to notices under section 6404(g)(1) that are provided on or after November 26, 2007, with respect to individual Federal income tax returns that were timely filed before that date. This notice provides interim guidance and will remain in effect until further guidance or regulations are issued.

BACKGROUND

Effective for taxable years ended after July 22, 1998, if an individual taxpayer files a Federal income tax return on or before the due date for that return (including extensions), and if the Service does not timely provide a notice to that taxpayer specifically stating the taxpayer's liability and the basis for that liability, then the Service shall generally suspend the imposition of any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return that is computed by reference to the period of time the failure continues and that is properly allocable to the suspension period. Prior to amendment by the Small Business and Work Opportunity Tax Act of 2007 (the Act), a notice is timely if provided before the close of the eighteen-month period beginning on the later of the date on which the return is filed or the due date of the return without regard to extensions. The suspension period begins on the day after the close of the eighteen-month period and ends twenty-one days after the Service provides the notice. This suspension rule applies separately with respect to each item or adjustment.

The Act amended section 6404(g) by striking "18-month period" in paragraphs (1)(A) and (3)(A) and inserting "36-month period." The Act states that the amendment "shall apply to notices provided by the Secretary of the Treasury or his delegate after the date that is six months after the date of enactment" of the Act — that is, on or after November 26, 2007. In a recent Notice of Proposed Rulemaking and Notice of Public Hearing on the Application of Section 6404(g) of the Internal Revenue Code Suspension Provisions, the Treasury Department and the Service acknowledged that questions have been raised regarding the effective date of the changes made by the Act, specifically how the amendment is intended to apply to notices provided on or after November 26, 2007, and stated that further guidance was under consideration. See Prop. Treas. Reg. § 301.6404–4, 72 Fed. Reg. 34199, 34200 (June 21, 2007). This notice provides that guidance.

DISCUSSION

The Act extends to thirty-six months the period within which the Service may issue a notice to an individual taxpayer specifically stating the taxpayer's liability and the basis for that liability before the accrual of interest and certain penalties are suspended under section 6404(g). The Service will apply the following rules to notices issued on or after November 26, 2007, that relate to a return that was timely filed before that date.

1. If, as of November 25, 2007, the eighteen-month period has closed and the Service has not provided notice to the taxpayer, interest and applicable penalties will be suspended beginning on the day after the close of the eighteen-month period and ending on the date that is twenty-one days after the notice is provided.

2. In all other cases, interest and applicable penalties will be suspended beginning on the day after the close of the thirty-six month period and ending on the date that is twenty-one days after the notice is provided.

The following examples illustrate these rules. The examples assume that none of the exceptions in section 6404(g)(2) to the general rule for suspension applies. The dates in the examples are used to illustrate the effective date changes made by the Act and do not provide guidance as to the computation of interest generally.

Example 1: An individual files a federal income tax return for 2006 by April 17, 2007 (the last day to timely file pursuant to section 7503). On January 2, 2009 (less than thirty-six months after the due date of the return), the Service provides a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. Because the eighteen-month period has not closed as of November 25, 2007, interest and applicable penalties will not be suspended with respect to the taxpayer's return.

Example 2: An individual files a federal income tax return for 2005 by April 17, 2006 (the last day to timely file pursuant to section 7503). On December 26, 2007, the Service provides a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. Because the eighteen-month period has closed as of November 25, 2007, interest and applicable penalties will be suspended with respect to the taxpayer's return beginning on October 17, 2007 (the day after the close of the eighteen-month period), and ending on January 16, 2008 (the date that is twenty-one days after the notice is provided).

Example 3: An individual files a federal income tax return for 2006 by April 17, 2007 (the last day to timely file pursuant to section 7503). The individual consents to extend the time within which the Service may assess any tax due on the return until June 30, 2011. On December 20, 2010, the Service provides a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. Because the eighteen-month period has not closed as of November 25, 2007, interest and applicable penalties will be suspended beginning on April 17, 2010 (the day after the close of the thirty-six month period), and ending on January 10, 2011 (the date that is twenty-one days after the notice is provided).

DRAFTING INFORMATION

The principal author of this notice is Stuart Spielman of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Stuart Spielman at (202) 622–3620 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 446, 481.)

Rev. Proc. 2007–67

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 97–27, 1997–1 C.B. 680, as modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, as amplified and clarified by Rev. Proc. 2002–54, 2002–2 C.B. 432, which provides the general procedures for obtaining the advance consent of the Commissioner of Internal Revenue

to change a method of accounting. This revenue procedure allows taxpayers, under certain conditions, to request to revise the year of change for a Form 3115, *Application for Change in Accounting Method*, that is pending in the national office, and modifies the period for taking into account a net positive adjustment under § 481(a) of the Internal Revenue Code when the Commissioner approves the taxpayer's request to revise the year of change.

SECTION 2. BACKGROUND

.01 Section 446(e) states that, except as otherwise provided, a taxpayer must secure the consent of the Secretary before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(i) of the Income Tax Regulations requires that, in general, in order to obtain the Commissioner's consent to a change in accounting method, a taxpayer must file a Form 3115 during the taxable year in which the taxpayer desires to make the proposed change.

.02 Rev. Proc. 97–27 provides the general procedures for obtaining the advance consent of the Commissioner to change a method of accounting. *See also* Rev. Proc. 2007–1, 2007–1 I.R.B. 1 (or successor).

.03 Section 3.05 of Rev. Proc. 97–27 defines the year of change as the taxable year for which a change in method of accounting is effective, that is, the first taxable year the new accounting method is to be used. The year of change is also the first taxable year for complying with the terms and conditions of the Commissioner's consent to change a method of accounting.

.04 Section 5.02(3)(a) of Rev. Proc. 97–27 provides, in general, that the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change.

.05 In some instances a taxpayer's Form 3115 filed under Rev. Proc. 97–27 may be pending in the national office when the taxpayer prepares and files its federal income tax return for the requested year of change. Therefore, the Service has determined that it is appropriate, under certain conditions, to allow a taxpayer to request to revise the year of change for a pending Form 3115.

SECTION 3. CHANGES TO REV. PROC. 97–27

.01 Section 5.02(3)(a) of Rev. Proc. 97–27 is modified to read as follows:

(a) *In general.* Except as otherwise provided in sections 5.02(3)(b), 7.03, and 12.01(3) of this revenue procedure, the § 481(a) adjustment period is four taxable years for a net positive adjustment for an accounting method change, and one taxable year for a net negative adjustment for an accounting method change.

.02 Rev. Proc. 97–27 is modified to renumber sections 12 through 15 as sections 13 through 16.

.03 Rev. Proc. 97–27 is modified by inserting new section 12 to read as follows:

SECTION 12. REQUEST TO REVISE THE YEAR OF CHANGE

.01 *In general.* The taxpayer may request, and the Service ordinarily will allow, the taxpayer to revise the year of change for a Form 3115 that is pending in the national office to a subsequent taxable year, but no later than the taxpayer's current taxable year (with no additional user fee), in lieu of submitting a new Form 3115 for the subsequent taxable year, under the following conditions:

(1) The taxpayer must submit a written request pursuant to section 12.04 of this revenue procedure to revise the year of change on or after, but not before, the first day of the fourth month following the month in which the taxpayer's federal income tax return is due (without regard to extension) for the original year of change requested on the Form 3115 (for example, a calendar year C corporation must submit a written request on or after, but not before, July 1 following the year of change requested on the Form 3115);

(2) The Form 3115 is pending in the national office on the date of the request; and

(3) Unless the Commissioner has determined that the requested change in accounting method will be made using a cut-off method or a modified cut-off method —

(a) The taxpayer must agree, in writing, to accelerate into the revised year of change the percentage of any net positive § 481(a) adjustment the taxpayer would have taken into account for each prior taxable year under section 5.02(3)(a) of this revenue procedure had the taxpayer not revised the year of change (for example, if the year of change is revised to the first succeeding taxable year, the taxpayer must agree to take into account one-half of any net positive § 481(a) adjustment in the revised year of change and one-fourth in each of its next two taxable years); and

(b) The taxpayer must agree to provide the § 481(a) adjustment (positive or negative) for the revised year of change within 21 calendar days (or a longer period if agreed to by the national office) after the Service first notifies the taxpayer that its request to revise the year of change is approved.

.02 *Multiple applicants on one Form 3115.* If the Form 3115 is for an identical change in accounting method for more than one applicant, the taxpayer must request to revise the year of change for all applicants to which the Form 3115 relates.

.03 *Compelling circumstances.*

(1) *In general.* In the case of a taxpayer that does not meet the condition in section 12.01(1) of this revenue procedure, a taxpayer with compelling circumstances may request to revise the year of change for the Form 3115, in lieu of submitting a new Form 3115 for the proposed revised year of change. The taxpayer must demonstrate those compelling circumstances. An example of compelling circumstances would include the following.

(2) *Example.* A calendar year partnership with 50 individual partners timely files a Form 3115 under Rev. Proc. 97–27 for a change in method of accounting for its 2007 taxable year. The partnership's Form 1065, *U.S. Return of Partnership Income*, and Schedules K–1, *Partner's Share of Income, Deductions, Credits, etc.*, and the partners' Forms 1040, *U.S. Individual Income Tax Return*, for the requested year of change are all due April 15, 2008. On March 17, 2008, the partnership submits a request to revise the year of change for its pending Form 3115 to its 2008 taxable year because the partnership's Form 3115 is pending in the national office. Because the Form 3115 is pending in the national office 30 days prior to the due date of the partners' Forms 1040, the partnership will be unable to provide timely Schedules K–1 that take into account the proposed accounting method change before the partners prepare and file their 2007 Forms 1040. Therefore, to avoid the potential for the 50 partners to be required to file amended 2007 Forms 1040 to take into account the partnership's requested change in method of accounting for the 2007 taxable year, once approved, the Service will ordinarily allow the partnership to revise the year of change for its Form 3115 to its 2008 taxable year. If the accounting method change is approved for the partnership's 2008 taxable year, in lieu of tak-

ing into account any net positive § 481(a) adjustment over four taxable years, the partnership must take into account one-half of any net positive § 481(a) adjustment in its 2008 taxable year and one-fourth in each of its next two taxable years.

.04 *Submitting a request for a revised year of change.* A request to revise the year of change for a Form 3115 pending in the national office should include the name of the filer (and each applicant, if applicable) on the Form 3115, the national office reference number (for example, CAM–123456–07), the name of the national office contact person for the Form 3115 (if known), the due date (without extension) for the filer's federal income tax return for the year of change, and a statement agreeing to the applicable requirements in section 12.01(3) of this revenue procedure. The request must be accompanied by the penalties of perjury statement in section 9.08(3) of Rev. Proc. 2007–1 (or successor) and should be submitted to the applicable address in section 9.08(6) of Rev. Proc. 2007–1 (or successor). Alternatively, the request may be faxed to a fax number provided by the national office contact person for the Form 3115. If faxed, a copy of the request and an original signed penalties of perjury statement must also be mailed or delivered to the applicable address in section 9.08(6) of Rev. Proc. 2007–1 (or successor).

.05 *Notification of approval or denial.* The national office will notify the taxpayer, orally and later in writing, of the approval or denial of the taxpayer's request to revise the year of change for a pending Form 3115.

.06 *Service's discretion to deny a request.* The Service reserves the right to deny a taxpayer's request for a revised year of change for a pending Form 3115 in any situation in which the Service determines it would not be in the best interest of sound tax administration to allow the taxpayer to revise the year of change. A taxpayer is not entitled to a conference with the Service if the request to revise the year of change for a pending Form 3115 is denied.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97–27 is modified.

SECTION 5. EFFECTIVE DATE

.01 *In general.* This revenue procedure is effective for Forms 3115 filed on or after, or pending in the national office on, November 6, 2007.

.02 *Transition rule for pending consent agreements.* If on or before November 26, 2007, a taxpayer has received a letter ruling approving a change in accounting method for which the taxpayer has not signed and returned the consent agreement and the period of time for signing and returning the consent agreement (see section 8.11 of Rev. Proc. 97–27) has not expired, the taxpayer may request to revise the year of change for the change in accounting method under the provisions of this revenue procedure. The taxpayer must submit any such request to revise the year of change prior to, and within the period of time for, signing and returning the consent agreement.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Brenda D. Wilson of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Wilson at (202) 622–4800 (not a toll-free call).

Part IV. Items of General Interest

Partial Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Foreign Tax Credit: Notification of Foreign Tax Redeterminations

REG–209020–86

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking and notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document withdraws portions of the notice of proposed rulemaking published on June 23, 1988, relating to sections 905(c) and 6689 (the 1988 proposed regulations). In addition, in this issue of the Bulletin, the IRS and the Treasury Department are issuing temporary regulations relating to a taxpayer's obligation under section 905(c) of the Internal Revenue Code to notify the IRS of a foreign tax redetermination. The IRS and the Treasury Department are also issuing temporary regulations on Procedure and Administration under section 6689 relating to the civil penalty for failure to notify the IRS of a foreign tax redetermination as required under section 905(c). These temporary regulations affect taxpayers that have paid foreign taxes which have been redetermined and provide guidance needed to comply with statutory changes made to the applicable law by the Taxpayer Relief Act of 1997 and the American Jobs Creation Act of 2004. The text of those temporary regulations (T.D. 9362) also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by February 5, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–209020–86), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–209020–90), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–209020–86).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Teresa Burridge Hughes, (202) 622–3850 (not a toll-free number); concerning the submission of comments, Kelly Banks, (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 7, 2008. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this notice of proposed rulemaking are in §1.905–4. This information is required to enable the IRS to verify the amounts of the foreign tax redeterminations and to determine the amount of the penalty under section 6689, if a taxpayer fails to notify the IRS of a foreign tax redetermination. This information will be used by the IRS for examination purposes. The collections of information are mandatory. The likely respondents are individuals and business or other for-profit institutions.

Estimated total annual reporting: 54,000 hours.

The estimated annual burden per respondent varies from 3 hours to 8 hours, depending on individual circumstances, with an estimated average of 4.2 hours.

Estimated number of respondents: 13,000.

Estimated frequency of responses: Annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On June 23, 1988, the IRS published in the **Federal Register** a notice of proposed rulemaking (53 FR 23659) (INTL–061–86, 1988-2 C.B. 824) (the 1988 proposed regulations) that would have provided rules with respect to the time and manner of reporting a foreign tax redetermination and to the penalty under section 6689. Written comments were received; however, no hearing was requested

or held. Subsequently, section 1102(a)(1) and 1102(a)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 963–966 (1997)), amended section 905(c), effective for taxes paid or accrued in taxable years beginning after December 31, 1997. Subsequently, section 408(a) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418, 1499 (2004)), modified section 986(a), effective for taxable years beginning after December 31, 2004. In light of the comments received on the 1988 proposed regulations and the statutory changes to sections 905(c) and 986(a), sections of the 1988 proposed regulations are revised and other sections are withdrawn. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to the following regulations, §§1.905–3, 1.905–4, 1.905–5, and 301.6689–1. With respect to §1.905–4, it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information requirement under §1.905–4 that is imposed on small entities flows directly from section 905(c), which states that, "[T]he taxpayer shall notify the Secretary," of a foreign tax redetermination that may result in a redetermination of the taxpayer's United States tax liability. In order for the taxpayer to satisfy this notification requirement, information with respect to all foreign tax redeterminations must be collected. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of this document is Teresa Burridge Hughes, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development.

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Partial Withdrawal of a Notice of Proposed Rulemaking

Under the authority of 26 U.S.C. 7805, §1.905–3(d)(2)(iii) and (iv) and §1.905–3(d)(4) of the notice of proposed rulemaking (INTL–061–86, REG–209020–86) published in the **Federal Register** on June 23, 1988 (53 FR 23659) are withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.905–3 is added to read as follows:

§1.905–3 Adjustments to United States tax liability and to the pools of post-1986 undistributed earnings and post-1986 foreign income taxes as a result of a foreign tax redetermination.

[The text of this section is the same as the text of §1.905–3T(a) through (e) published elsewhere in this issue of the Bulletin.]

Par. 3. Section 1.905–4 is added to read as follows:

§1.905–4 Notification of foreign tax redetermination.

[The text of this section is the same as the text of §1.905–4T(a) through (f)(2) published elsewhere in this issue of the Bulletin.]

§1.905–5 Foreign tax redeterminations and currency translation rules for foreign tax redeterminations occurring in taxable years beginning prior to January 1, 1987.

[The text of this section is the same as the text of §1.905–5T(a) through (f) published elsewhere in this issue of the Bulletin.]

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The citation authority for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 5. Section 301.6689–1 is added to read as follows:

§301.6689–1 Failure to file notice of redetermination of foreign tax .

(a) [The text of the proposed amendments to §301.6689–1(a) is the same as the text of §301.6689–1T(a) published elsewhere in this issue of the Bulletin.]

(b) through (d) [Reserved]. For further guidance, see §301.6689–1T(b) through (d).

(e) [The text of the proposed amendments to §301.6689–1(e)(1) is the same as the text of §301.6689–1T(e)(1) published elsewhere in this issue of the Bulletin.]

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 6, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 7, 2007, 72 F.R. 62805)

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Reinstatements, Suspensions, Censures, Disbarments, and Resignations

Announcement 2007-104

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Reinstatement To Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, The Director, Office of Professional Responsibility, may entertain a petition for reinstatement for any attorney, certified public accountant, enrolled agent, or enrolled actuary censured, suspended, or disbarred, from practice before the Internal Revenue Service.

The following individuals' eligibility to practice before the Internal Revenue Service has been restored:

Name	Address	Designation	Date of Reinstatement
Dotson, Lewis S.	Mattoon, IL	Attorney	April 8, 2007
Adams, Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	July 30, 2007
Cramer, George C.	Chicago, IL	CPA	July 30, 2007
Garlikov, Mark B.	Dayton, OH	Attorney	July 30, 2007
Grant, Elaine C.	Woodway, WA	Enrolled Agent	July 30, 2007
Rubesh, Leland	Gillette, WY	CPA	July 30, 2007
Schawe, Rudolph B.	Brenham, TX	Enrolled Agent	July 30, 2007
Sobel, Herbert L.	Elkins Park, PA	CPA	July 30, 2007
Welch, Frank G.	Stamford, CT	CPA	July 30, 2007
Ferguson, Charles E.	Naples, FL	CPA	July 31, 2007
Lim, Edgar E.	St. Louis, MO	Attorney	July 31, 2007
Sneathen, Lowell D.	Orange, CA	CPA	August 30, 2007
Smith, David B.	Kettering, OH	Enrolled Agent	September 9, 2007
Young, Ronald B.	Fairfield, CT	CPA	September 9, 2007
Sheiman, Alan P.	Sherman Oaks, CA	Enrolled Agent	September 14, 2007
DiSiena, Frank E.	Somers, NY	CPA	September 19, 2007

Name	Address	Designation	Date of Reinstatement
Leggio, Joseph J.	Katonah, NY	CPA	September 24, 2007

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Hunter, Richard	Moweaqua, IL	Enrolled Agent	Indefinite from July 16, 2007
Sheehy, William J.	Northville, MI	Attorney	Indefinite from July 16, 2007
Szwyd, Edward R.	Housatonic, MA	CPA	Indefinite from July 16, 2007
Lettieri, Louis E.	Red Bank, NJ	CPA	Indefinite from August 1, 2007
Stein, Jerold A.	Alpharetta, GA	CPA	Indefinite from August 1, 2007
Tutino, Philip R.	East Hampton, NY	CPA	Indefinite from August 1, 2007
Dorr, Mark A.	Gillette, WY	CPA	Indefinite from August 7, 2007
Nelson, Carole S.	Riverside, CA	Enrolled Agent	Indefinite from August 8, 2007
Siegel, Herbert	New City, NY	CPA	Indefinite from August 10, 2007
Taylor, Linda W.	Las Vegas, NV	CPA	Indefinite from August 15, 2007
Finkelstein, Meyer	Staten Island, NY	CPA	Indefinite from August 15, 2007

Name	Address	Designation	Date of Suspension
Schenck, Thomas M.	Tampa, FL	CPA	Indefinite from August 20, 2007
Shah, Sudhir P.	Richardson, TX	CPA	Indefinite from August 20, 2007
Bender, Elmer P.	Missoula, MT	CPA	Indefinite from August 31, 2007
Tselepis, John	Jarrettsville, MD	CPA	Indefinite from September 5, 2007
Perez, Ricardo L.	Cedar Lake, IN	CPA	Indefinite from September 10, 2007
Golden, Roberta A.	Framington, MA	Attorney	Indefinite from September 13, 2007
Ward, Thomas R.	St. Louis Park, MN	Attorney	Indefinite from September 13, 2007

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Murphy, John F.	Wellsboro, PA	Attorney	Indefinite from June 28, 2007
Aakre, Steven K.	Hawley, MN	Attorney	Indefinite from July 11, 2007
Brogan, Jane K.	York, NE	Attorney	Indefinite from July 11, 2007
Clark, Clifford A.	Raleigh, NC	CPA	Indefinite from July 11, 2007

Name	Address	Designation	Date of Suspension
Downing, Jr., Eugene W.	Arlington, MA	Attorney	Indefinite from July 11, 2007
Kahn, Arthur M.	Woodstock, NY	Attorney	Indefinite from July 11, 2007
Kossmeyer, Carl F.	Town and Country, MO	CPA	Indefinite from July 11, 2007
Lee, John C.	Charlotte, NC	Attorney	Indefinite from July 11, 2007
McAvoy, Donald L.	Windermere, FL	CPA	Indefinite from July 11, 2007
McCabe, Edwin A.	Gloucester, MA	Attorney	Indefinite from July 11, 2007
O'Donnell, Judith R.	Westborough, MA	Attorney	Indefinite from July 11, 2007
Taylor, John G.	Lincoln, NE	Attorney	Indefinite from July 11, 2007
Turner, D. Scott	Mooresville, NC	Attorney	Indefinite from July 11, 2007
Csaszar, James J.	Columbus, OH	CPA	Indefinite from July 13, 2007
Fischer, Mark W.	Boulder, CO	Attorney	Indefinite from July 16, 2007
Behunin, Michael N.	Sandy, UT	Attorney	Indefinite from August 8, 2007
Carpenter, Jr., Darwin R.	Melbourne, FL	CPA	Indefinite from August 23, 2007
Gresham, James L.	Broken Arrow, OK	CPA	Indefinite from August 23, 2007
Krezminski, Allen D.	Milwaukee, WI	Attorney	Indefinite from August 23, 2007

Name	Address	Designation	Date of Suspension
Neary, Hugh M.	Ottumwa, IA	Attorney	Indefinite from August 23, 2007
Weiss, Randy A.	Potomac, MD	Attorney	Indefinite from August 23, 2007
Whiddon, Edward L.	Houston, TX	CPA	Indefinite from August 23, 2007
Hazen, Robert D.	Lindon, UT	CPA	Indefinite from August 29, 2007
Schafer, III, Harry J.	Edmond, OK	CPA	Indefinite from September 6, 2007
Pullin, Wendy F.	San Antonio, TX	CPA	Indefinite from September 24, 2007

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Newton, Douglas M.	Fernandina Beach, FL	CPA	Indefinite from June 4, 2007
Snell, Barry A.	Santa Monica, CA	CPA	Indefinite from June 6, 2007
Khoury, Naif S.	Fort Smith, AR	Attorney	Indefinite from June 14, 2007
Bukovac, Jane	Alexandria, VA	Enrolled Agent	Indefinite from June 29, 2007
Kreke, David J.	Bartelso, IL	Enrolled Agent	Indefinite from July 12, 2007
Dunkley, John D.	San Antonio, TX	Enrolled Agent	Indefinite from July 27, 2007

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Ruocchio, Robert	Havertown, PA	CPA	June 11, 2007
Turner, John S.	Paradise, CA	Enrolled Agent	June 15, 2007
Johnson, Ted R.	Frankfort, IN	Attorney	July 30, 2007
Ayers, Dani D.	Kelseyville, CA	Enrolled Agent	August 6, 2007

Announcement 2007–110

This announcement is an update to Publication 1187, *Specifications for Filing Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically* revised September 2006. Continue to use this Publication along with the changes listed below for your Tax Year 2007 filing. The following changes are effective for Tax Year 2007 filed in calendar year 2008.

- An explanatory note was added to the Recipient 'Q' Record which reads: If you are a nominee that is the withholding agent under Code Section 1446, enter the Publicly Traded Partnership's (PTP) name and other information in the NQI/FLW-THR fields; positions 401–666.

- In the Recipient 'Q' Record, a new field, NQI/FLW-THR State Code, was added to positions 643–644. Enter the two-alpha character state code (see table Part A, Sec. 14). If a state code or APO/FPO is not applicable then blank fill.

- Additional instructions were added to the Recipient "Q" Record, NQI/FLW-THR Country Code, positions 647–648. The instructions read: Enter the two-character Country Code abbreviation, where the NQI/FLW-THR is located. Enter blanks if the NQI/FLW-THR has a U.S. address.

- The Field Title was changed and additional instructions were added to the Recipient "Q" Record, NQI/FLW-THR Postal Code or ZIP Code, positions 649–657. The instructions read: Enter the alpha/numeric foreign postal code or U.S. ZIP Code for all U.S. addresses including territories, possessions and APO/FPO. Enter the code in the left most position and blank fill the remaining positions. **DO NOT** use hyphens or blanks between numbers or letters (*e.g.* if the postal code written as A6B 3C5 input as A6B3C5). Left-justify.

If you have questions concerning the filing of Form 1042–S, *Foreign Person's U.S. Source Income Subject to Withholding*, please contact the Internal Revenue Service ECC-MTB toll-free at 866–455–7438.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–1: Gross income.
(Also §§ 134, 140; § 1.6041–1.)

This ruling provides that payments made by the U.S. Department of Veterans Affairs under the compensated work therapy program are exempt from federal income tax as veterans' benefits. Rev. Rul. 65–18 revoked, Rev. Rul. 72–605 amplified.

Rev. Rul. 2007–69

ISSUES

(1) Are payments made by the U.S. Department of Veterans Affairs (VA) under the compensated work therapy program described in 38 U.S.C. § 1718 (CWT program) exempt from federal income tax as veterans' benefits?

(2) Are payments made by the VA under the CWT program required to be reported on an information return?

FACTS

The CWT program administered by the VA provides assistance to veterans unable to work and support themselves. Many of the veterans in the program have histories of one or more conditions such as psychiatric illness, substance abuse, and homelessness. Under the program, the VA provides a range of vocational rehabilitation services, with the degree of structure and level of support provided to the participating veteran geared to his or her needs. The goal of the program is to assist in restoring, to the maximum extent possible, the physical and psychological functioning of ill or disabled veterans. *See* 38 U.S.C. § 1701.

Title 38 of the United States Code addresses veterans' benefits. Section 1718, entitled "Therapeutic and Rehabilitative Activities," provides that the VA may enter into contracts with third parties to provide therapeutic work for patients in VA health care facilities. Section 1718(c)(1) establishes the "Department of Veterans Affairs Special Therapeutic and Rehabilitation Activities Fund" (Fund), from which distributions are to be made to patients for therapeutic work. Fund payments are intended to furnish veterans with work skills training, employment support, and job development and placement services, although the primary objective of the program is therapy and rehabilitation. *See* 38 U.S.C. § 1718(a) and (d).

With respect to the taxation of veterans' benefits, 38 U.S.C. § 5301(a)(1) provides that payments of benefits due or to become due under any law administered by the VA made to, or on account of, a beneficiary shall be exempt from taxation.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that gross income includes all income from whatever source derived, unless specifically excluded by law.

Section 134(a) provides that gross income does not include any qualified military benefit. The term "qualified military benefit" means any allowance or in-kind benefit (other than personal use of a vehicle) which—

(A) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services, and

(B) was excludable from gross income on September 9, 1986, under any provision of law, regulation, or administrative practice that was in effect on such date (other than a provision of Title 26). Section 134(b)(1).

The legislative history to § 134 indicates that the allowances that were authorized on September 9, 1986, and excludable from gross income on that date, include veterans' benefits authorized under 38 U.S.C. § 3101 (now 38 U.S.C. § 5301). *See* H.R. Conf. Rep. No. 841 (Vol. II), 99th Cong. 2d Sess. 548 (1986). *See also* § 140(a)(3) (cross-referencing 38 U.S.C. § 5301 for the exemption from taxation of benefits under laws administered by the VA).

Rev. Rul. 72–605, 1972–2 C.B. 35, holds that payments of benefits under any law administered by the VA are excludible from the gross income of a recipient.

Rev. Rul. 65–18, 1965–1 C.B. 32, holds that certain payments made by the VA under the CWT program in 38 U.S.C. § 618 (the predecessor to 38 U.S.C. § 1718) are includible in a recipient's gross income as compensation for services, even though intended for therapeutic or rehabilitative purposes. Rev. Rul. 65–18 also requires information reporting on Form 1099 with respect to these payments. See § 1.6041–1(i) (requiring information returns on Form 1099 of certain payments made by any agency of the United States).

In *Wallace v. Commissioner*, 128 T.C. 132 (2007), *acq.*, 2007–44 I.R.B. ___, the Tax Court disagreed with Rev. Rul. 65–18 and held that payments made by the VA for work performed under CWT programs are exempt from federal income tax as veterans' benefits within the meaning of 38 U.S.C. § 5301.

The Service agrees with the *Wallace* decision that payments made by the VA under the CWT program are veterans' benefits within the meaning of 38 U.S.C. § 5301. Accordingly, the payments are qualified military benefits under § 134 and are exempt from federal income tax.

HOLDINGS

(1) Payments made by the VA under the CWT program are exempt from federal income tax as veterans' benefits.

(2) Because payments made by the VA under the CWT program are exempt from federal income tax, the payments are not required to be reported on an information return.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 65–18 is revoked. Rev. Rul. 72–605 is amplified.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael F. Schmit of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue ruling, contact Mr. Schmit at (202) 622-4960 (not a toll-free call).

Section 134.—Certain Military Benefits

A revenue ruling provides that payments made by the U.S. Department of Veterans Affairs under the compensated work therapy program are exempt from federal income tax as veterans' benefits. See Rev. Rul. 2007-69, page 1083.

Section 140.—Cross References to Other Acts

A revenue ruling provides that payments made by the Department of Veterans Affairs under the compensated work therapy program are exempt from federal income tax as veterans' benefits. See Rev. Rul. 2007-69, page 1083.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011–5: Required use of magnetic media for corporate income tax returns.

T.D. 9363

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Returns Required on Magnetic Media

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the requirements for filing corporate income tax returns and returns of organizations required to file returns under section 6033 on magnetic media pursuant to section 6011(e) of the Internal Revenue Code (Code). The term magnetic media includes any magnetic media permitted under applicable regulations, revenue procedures, or publications, including electronic filing. The final regulations are necessary to update and clarify the rules and procedures for corporations and organizations that are required to file their returns electronically. The final regulations affect corporations, including electing small business corporations (S corporations), with assets of $10 million or more that file Form 1120, *U.S. Corporation Income Tax Return*, or Form 1120S, *U.S. Income Tax Return for an S Corporation*; exempt organizations with assets of $10 million or more that are required to file returns under section 6033, and private foundations or section 4947(a)(1) trusts that are required to file returns under section 6033.

DATES: *Effective Date:* These regulations are effective November 13, 2007.

Applicability Date: These regulations are applicable November 13, 2007.

FOR FURTHER INFORMATION CONTACT: Michael E. Hara, (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 12, 2005, the IRS published a notice of proposed rulemaking (by cross reference to temporary regulations) and a notice of public hearing, (REG–130671–04, 2005–1 C.B. 694) (70 FR 2075). The proposed regulations require certain large corporations, including S corporations, to file their corporate income tax returns electronically. The proposed regulations also require certain large exempt organizations, nonexempt charitable trusts, and exempt and nonexempt private foundations to electronically file those returns required to be filed under section 6033.

A public hearing was held on March 16, 2005. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision. The temporary regulations under sections 6011, 6033, and 6037 are removed.

Summary of Comments and Explanation of Revisions

1. *Returns Covered.*

The proposed regulations required electronic filing of Forms 1120 and 1120S by corporations required to file at least 250 returns during the calendar year, required to file corporate income tax returns, and that had total assets of $50 million or more as shown on Schedule L of their Form 1120 or 1120S for taxable years ending on or after December 31, 2005. The proposed regulations also required electronic filing of Forms 1120 and 1120S by corporations required to file at least 250 returns during the calendar year, required to file corporate income tax returns, and that had total assets of $10 million or more as shown on Schedule L of their Form 1120 or 1120S for taxable years ending on or after December 31, 2006. The proposed regulations also required electronic filing of Form 990, *Return of Organization Exempt From Income Tax*, by organizations required to file at least 250 returns during the calendar year, required to file Form 990 and that had, for a taxable year ending on or after December 31, 2005, total assets as of the end of the taxable year of $100 million or more or that, for a taxable year ending on or after December 31, 2006, had total assets as of the end of the taxable year of $10 million or more. The proposed regulations also required electronic filing of Form 990–PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*, regardless of total assets, by organizations required to file at least 250 returns during the calendar year that were required to file Form 990–PF for taxable years ending on or after December 31, 2006.

Except as described in the preamble, the final regulations clarify that the electronic filing requirement applies to all members of the Form 1120 and Form 1120S series of returns, including amended and superseding returns, and to all members of the Form 990 series of returns, including amended and superseding returns. A member of the Form 1120 series includes, for example, the Form 1120–F, *U.S. Income Tax Return of a Foreign Corporation.*

The IRS currently does not have the capability to accept electronic filing of certain types of Form 1120, Form 1120S, and Form 990 series of returns, such as a Form 1120 for a taxpayer that has changed its accounting period, or a Form 990 or Form 990–PF for an organization not recognized as exempt or one that has an application for exempt status pending. These regulations thus exclude those returns from the electronic filing requirement. The IRS will announce the returns in the Form 1120, Form 1120S, and Form 990 series that are required to be filed electronically and the returns that are excluded from electronic filing under these regulations in its publications, forms and instructions, including

those instructions and Frequently Asked Questions (FAQs) posted electronically to the IRS.gov website. The Treasury Department and the IRS intend to require electronic filing of additional corporate income tax returns, excise tax returns and returns required to be filed under section 6033 in the Form 1120, Form 1120S, and Form 990 series as the IRS increases its capability to receive these forms electronically, provided that the Treasury Department and the IRS determine that filers are able to comply with the electronic filing requirements at a reasonable cost.

2. *First Year and Last Year Exclusions.*

The proposed regulations provided exclusions from the requirement to file electronically for certain corporations and organizations that had not had a longstanding filing obligation. Under the proposed regulations, corporations and organizations were not required to file their returns electronically if they were not required to file a Form 1120, Form 1120S, Form 990, or Form 990–PF for the preceding taxable year or had not been in existence for at least one calendar year prior to the due date (not including extensions) of their Form 1120, Form 1120S, Form 990, or Form 990–PF. These transition rules were designed to relieve taxpayer burden during the first year of implementation of the mandatory electronic filing regulations, but caused unnecessary complexity in determining whether a corporation or other organization was entitled to the first year exclusion when the corporation or organization was a part of a reorganization. The Treasury Department and the IRS have determined that these transition rules are no longer necessary and that corporations and other organizations should be able to comply at a reasonable cost with the requirement to file returns electronically.

3. *250 Return Requirement.*

Under the proposed regulations, the determination of whether an entity is required to file at least 250 returns is made by aggregating all returns, regardless of type, that the entity is required to file over the calendar year, including, for example, income tax returns, returns required under section 6033, information returns, excise tax returns, and employment tax returns. The final regulations clarify that in the case of a short year return, an entity is required to file electronically if, during the calendar year which includes the short taxable year of the entity, the entity is required to file at least 250 returns of any type, including, for example, income tax returns, returns required under section 6033, information returns, excise tax returns, and employment tax returns.

4. *Hardship Waiver.*

Three commentators requested that the IRS institute procedures allowing the Service to waive the requirement to file returns electronically. One commentator recommended that the final guidance on waivers include a clear definition of what constitutes justification for a waiver, and a flexible standard on when a filer would qualify for a waiver. One commentator contended that cost to the filer should be a principal factor in obtaining a hardship waiver. On November 28, 2005, the IRS issued Notice 2005–88, 2005–2 C.B. 1060, which provides procedures for filers to request a waiver of the requirement to electronically file their returns. Notice 2005–88 provides that in determining whether to approve or deny a waiver request, the IRS will consider the filer's ability to timely file its return electronically without incurring an undue economic hardship. The notice provides that the IRS will generally grant waivers for filing returns electronically where the filer can demonstrate the undue hardship that would result by complying with the electronic filing requirement, including any incremental costs to the filer.

Another commentator contended that technological failures beyond the control of the filer should also not result in the assertion of penalties. For this reason, the commentator recommended that waivers be granted, especially during the first year or two during which a taxpayer is required to file electronically, in the following circumstances:

1. Where the software vendor used by the filer is unable to produce the software needed to e-file any return or schedule within a reasonable time period, perhaps six months before the end of the year for which the return is to be filed.

2. Where the filer discovers significant flaws in either the developer's software program or its own self-developed software during the first three months of the year in which the return is to be filed.

3. Where the filer after significant testing determines the need to switch software vendors in order to comply with the e-filing mandate.

4. Where the filer attempts to timely file the return electronically by the statutory deadline (including extensions), but transmission errors (such as Internet traffic, misrouting of information packets, or disconnects in the transmission) prevent the filing of the return.

Although Notice 2005–88 does not refer to these specific situations, the notice provides that the IRS will generally grant waivers for filing returns electronically where technology issues prevent the filer from filing its return electronically. The Treasury Department and the IRS believe, however, that it is the responsibility of the filer to review the capabilities and efficacy of the software they use to file their returns, to ensure that the software used will meet their specific filing requirements.

One commentator stated that there might be circumstances when an entity otherwise subject to the electronic filing requirements should be eligible for an automatic waiver as opposed to being required to file a formal waiver request. Another commentator recommended that the purchase and use of software developed by an approved vendor be sufficient evidence that a filer has made a good faith effort to comply with the regulations. The Treasury Department and the IRS believe that waiver requests should be considered on a case-by-case basis, based on each filer's particular facts and circumstances.

Additional guidance on situations in which returns are excluded from the electronic filing mandate is available in IRS Publication 4163, *Modernized e-file (MeF) Information for Authorized IRS e-file Providers Tax Year 2006*; and on the IRS.gov Internet site.

5. *Date of Filing.*

One commentator supported the concept and use of an electronic postmark, but requested clear and concise guidance as to when an electronically submitted return is deemed filed when such a return is rejected either because of transmission issues or IRS acceptance criteria. Notice 2005–88 provides that if the portion of a

return required to be filed electronically is transmitted on or before the due date (including extensions) and is ultimately rejected, but the electronic return originator and the filer comply with the specific requirements for timely submission of the return, the return will be considered timely filed and any elections attached to the return will be considered valid. The notice also provides that for taxable years ending on or after December 31, 2005, the IRS will allow the filer 20 calendar days from the date of first transmission to perfect the return for electronic resubmission.

6. *Effective Dates.*

Three commentators recommended that the IRS delay implementation of the requirement to file returns electronically. Both Treasury and the IRS believe that the vendor software is available, that the IRS' systems can accommodate the electronic filing requirement and that implementation of the electronic filing mandate can be accomplished successfully without undue burden by filers. Through October 2006, over 500,000 corporations of all sizes successfully electronically filed their Forms 1120 or 1120S for 2005, of which over 18,000 were corporations with assets exceeding $10 million. In addition, through December 2006, over 15,300 organizations of all sizes successfully electronically filed their Forms 990, 990–EZ or 990–PF for 2005. Accordingly, the recommendation to delay implementation has not been adopted.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

When an Agency issues a rulemaking proposal, the Regulatory Flexibility Act, 5 U.S.C. chapter 6 (RFA), requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" which will "describe the impact of the proposed rule on small entities." (5 U.S.C. §603(a)). Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

The Treasury decision affects corporations required to file corporate income tax returns that are required to file at least 250 returns during the calendar year and have total assets of $10 million or more for taxable years ending on or after December 31, 2006. Section 601(3) of the RFA defines a small business as having the same meaning as "small business concern" under section 3 of the Small Business Act, 15 U.S.C. 632. The IRS estimates that of the 6,294,000 entities required to file Forms 1120 or 1120S, 22,000 entities are required to electronically file these Forms. The IRS estimates that of the 22,000 entities required to electronically file Forms 1120 or 1120S, there are 9,500 organizations that will be required to file the Forms 1120 or 1120S electronically that qualify as small businesses. The 9,500 corporation estimate is based on Large and Mid-Size Business Division's estimates of the number of corporations that have assets between $10 million and $50 million as shown on their Schedule L of their Form 1120 or 1120S for taxable years ending on or after December 31, 2006, and that may have at least 250 employees based on the number of returns the corporation has filed, including Forms W–2. Therefore, the IRS has determined that this Treasury decision will have an impact on a substantial number of small businesses.

The Treasury decision also affects those organizations required to file Form 990 that are required to file at least 250 returns during the calendar year and have total assets of $10 million or more for taxable years ending on or after December 31, 2006. The Treasury decision also affects those organizations that are required to file Form 990–PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*, regardless of total assets. Section 601(4) of the RFA defines a small organization as any not-for-profit enterprise that is independently owned and operated and not dominant in its field (for example, private hospitals and educational institutions). The IRS estimates that of the 263,000 entities that are required to file the Form 990, there are 6,000 organizations that will be required to file the Form 990 electronically that qualify as small organizations. The 6,000 organization estimate is based on Tax Exempt and Government Entities Division's estimates of the number of entities that have assets between $10 million and $100 million as shown on their Schedule L of their Form 990 for taxable years ending on or after December 31, 2006 and that may have at least 250 employees based on the number returns the corporation has filed, including Forms W–2. The IRS also estimates that of the 85,000 entities that are required to file the Form 990–PF, there are 50 organizations that will be required to file the Form 990–PF electronically that qualify as small organizations. The 50 organizations estimate is based on Tax Exempt and Government Entities Division's estimates of the number of entities that may have at least 250 employees based on the number returns the corporation has filed, including Forms W–2. Therefore, the IRS has determined that this Treasury decision will have an impact on a substantial number of small organizations.

The IRS has also determined, however, that the impact on entities affected by the proposed rule will not be significant. The IRS and Treasury Department note that these regulations only prescribe the method of filing returns that are already required to be filed. Further, these regulations are consistent with the requirements imposed by statute. The burden on small entities to purchase the software to file its returns electronically is minimal as the software is widely available. Pricing for electronic filing software varies considerably. In many instances, the price for electronic filing is bundled with other services and products. Some software providers offer volume discounts, or unlimited filing for a fixed price. Some software providers offer free electronic filing if the taxpayer purchases a suite of other products or services. And in many cases, taxpayers will use the services of a tax practitioner to prepare and electronically file their return. Accordingly, direct comparison of the cost for electronic filing is difficult. The cost for the software to file returns electronically for small entities from software providers starts from $12.50 per return for on-line electronic filing of Forms 1120, and is free for Form 990 filers with less than $100,000 in gross revenue.

Finally, the IRS has provided procedures for filers to request a waiver of the requirement to electronically file their returns. Notice 2005–88 provides that in determining whether to approve or deny a waiver request, the IRS will consider the filer's ability to timely file its return electronically without incurring an undue economic hardship.

Accordingly, the IRS hereby certifies that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these final regulations is Michael E. Hara, Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6011–5 is added to read as follows:

§1.6011–5 Required use of magnetic media for corporate income tax returns.

The return of a corporation that is required to be filed on magnetic media under §301.6011–5 of this chapter must be filed in accordance with Internal Revenue Service revenue procedures, publications, forms, or instructions, including those posted electronically. (See §601.601(d)(2) of this chapter).

§1.6011–5T [Removed]

Par. 3. Section 1.6011–5T is removed.

Par. 4. Section 1.6033–4 is added to read as follows:

§1.6033–4 Required use of magnetic media for returns by organizations required to file returns under section 6033.

The return of an organization that is required to be filed on magnetic media under §301.6033–4 of this chapter must be filed in accordance with Internal Revenue Service revenue procedures, publications, forms, or instructions, including those posted electronically. (See §601.601(d)(2) of this chapter).

§1.6033–4T [Removed]

Par. 5. Section 1.6033–4T is removed.

Par. 6. Section 1.6037–2 is added to read as follows:

§1.6037–2 Required use of magnetic media for income tax returns of electing small business corporations.

The return of an electing small business corporation that is required to be filed on magnetic media under §301.6037–2 of this chapter must be filed in accordance with Internal Revenue Service revenue procedures, publications, forms, or instructions, including those posted electronically. (See §601.601(d)(2) of this chapter).

§1.6037–2T [Removed]

Par. 7. Section 1.6037–2T is removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 8. The authority citation for part 301 is amended by removing the entries for "Section 301.6011–5T", "Section 301–6033–4T", and "Section 301.6037–2T" and adding entries, in numerical order, to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.6011–5 also issued under 26 U.S.C. 6011. * * *

Section 301.6033–4 also issued under 26 U.S.C. 6033. * * *

Section 301.6037–2 also issued under 26 U.S.C. 6037. * * *

Par. 9. Section 301.6011–5 is added to read as follows:

§301.6011–5 Required use of magnetic media for corporate income tax returns.

(a) *Corporate income tax returns required on magnetic media*—(1) A corporation required to file a corporate income tax return on Form 1120, *"U.S. Corporation Income Tax Return,"* under §1.6012–2 of this chapter must file its corporate income tax return on magnetic media if the corporation is required by the Internal Revenue Code or regulations to file at least 250 returns during the calendar year. Returns filed on magnetic media must be made in accordance with applicable revenue procedures, publications, forms, or instructions. In prescribing revenue procedures, publications, forms, or instructions, the Commissioner may direct the type of magnetic media filing. (See §601.601(d)(2) of this chapter).

(2) All members of a controlled group of corporations must file their corporate income tax returns on magnetic media if the aggregate number of returns required to be filed by the controlled group of corporations is at least 250.

(b) *Waiver.* The Commissioner may grant waivers of the requirements of this section in cases of undue hardship. A request for waiver must be made in accordance with applicable revenue procedures or publications. The waiver also will be subject to the terms and conditions regarding the method of filing as may be prescribed by the Commissioner.

(c) *Failure to file.* If a corporation fails to file a corporate income tax return on magnetic media when required to do so by this section, the corporation is deemed to have failed to file the return. (See section 6651 for the addition to tax for failure to file a return). In determining whether there is reasonable cause for failure to file the return, §301.6651–1(c) and rules similar to the rules in §301.6724–1(c)(3) (undue economic hardship related to filing information returns on magnetic media) will apply.

(d) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term *magnetic media* means any magnetic media permitted under applicable regulations, revenue procedures, or publications. These generally include magnetic tape, tape cartridge, and diskette, as well as other media, such as electronic filing, specifically permitted

under the applicable regulations, procedures, publications, forms, or instructions. (See §601.601(d)(2) of this chapter).

(2) *Corporation.* The term *corporation* means a corporation as defined in section 7701(a)(3).

(3) *Controlled group of corporations.* The term *controlled group of corporations* means a group of corporations as defined in section 1563(a).

(4) *Corporate income tax return.* The term *corporate income tax return* means a Form 1120, "*U.S. Corporation Income Tax Return*," along with all other related forms, schedules, and statements that are required to be attached to the Form 1120, and all members of the Form 1120 series of returns, including amended and superseding returns.

(5) *Determination of 250 returns.* For purposes of this section, a corporation or controlled group of corporations is required to file at least 250 returns if, during the calendar year ending with or within the taxable year of the corporation or the controlled group, the corporation or the controlled group is required to file at least 250 returns of any type, including information returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns. In the case of a short year return, a corporation is required to file at least 250 returns if, during the calendar year which includes the short taxable year of the corporation, the corporation is required to file at least 250 returns of any type, including information returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns. If the corporation is a member of a controlled group, the determination of the number of returns includes all returns required to be filed by all members of the controlled group during the calendar year ending with or within the taxable year of the controlled group.

(e) *Example.* The following example illustrates the provisions of paragraph (d)(5) of this section:

Example. The taxable year of Corporation X, a fiscal year taxpayer with assets in excess of $10 million, ends on September 30. During the calendar year ending December 31, 2007, X was required to file one Form 1120, "*U.S. Corporation Income Tax Return*," 100 Forms W–2, "*Wage and Tax Statement*," 146 Forms 1099–DIV, "*Dividends and Distributions*," one Form 940, "*Employer's Annual Federal Unemployment (FUTA) Tax Return*," and four Forms 941, "*Employer's QUARTERLY Federal Tax Return*." Because X is required to file 252 returns during the calendar year that ended within its taxable year ending September 30, 2008, X is required to file its Form 1120 electronically for its taxable year ending September 30, 2008.

(f) *Effective/applicability dates.* This section applies to corporate income tax returns for corporations that report total assets at the end of the corporation's taxable year that equal or exceed $10 million on Schedule L of their Form 1120, for taxable years ending on or after December 31, 2006, except for the application of the short year rules in paragraph (d)(5) of this section, which is applicable for taxable years ending on or after November 13, 2007.

§301.6011–5T [Removed]

Par. 10. Section 301.6011–5T is removed.

Par. 11. Section 301.6033–4 is added to read as follows:

§301.6033–4 Required use of magnetic media for returns by organizations required to file returns under section 6033.

(a) *Returns by organizations required to file returns under section 6033 on magnetic media.* An organization required to file a return under section 6033 on Form 990, "*Return of Organization Exempt From Income Tax*," or Form 990–PF, "*Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*," must file its Form 990 or 990–PF on magnetic media if the organization is required by the Internal Revenue Code or regulations to file at least 250 returns during the calendar year ending with or within its taxable year. Returns filed on magnetic media must be made in accordance with applicable revenue procedures, publications, forms, or instructions. In prescribing revenue procedures, publications, forms, or instructions, the Commissioner may direct the type of magnetic media filing. (See §601.601(d)(2) of this chapter).

(b) *Waiver.* The Commissioner may grant waivers of the requirements of this section in cases of undue hardship. A request for waiver must be made in accordance with applicable revenue procedures or publications. The waiver also will be subject to the terms and conditions regarding the method of filing as may be prescribed by the Commissioner.

(c) *Failure to file.* If an organization required to file a return under section 6033 fails to file an information return on magnetic media when required to do so by this section, the organization is deemed to have failed to file the return. (See section 6652 for the addition to tax for failure to file a return.) In determining whether there is reasonable cause for failure to file the return, §301.6652–2(f) and rules similar to the rules in §301.6724–1(c)(3) (undue economic hardship related to filing information returns on magnetic media) will apply.

(d) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term *magnetic media* means any magnetic media permitted under applicable regulations, revenue procedures, or publications. These generally include magnetic tape, tape cartridge, and diskette, as well as other media, such as electronic filing, specifically permitted under the applicable regulations, procedures, publications, forms or instructions. (See §601.601(d)(2) of this chapter).

(2) *Return required under section 6033.* The term *return required under section 6033* means a Form 990, "*Return of Organization Exempt From Income Tax*," and Form 990–PF, "*Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*," along with all other related forms, schedules, and statements that are required to be attached to the Form 990 or Form 990–PF, and all members of the Form 990 series of returns, including amended and superseding returns.

(3) *Determination of 250 returns.* For purposes of this section, an organization is required to file at least 250 returns if, during the calendar year ending with or within the taxable year of the organization, the organization is required to file at least 250 returns of any type, including information returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns. In the case of a short year return, an organization is required to file at least 250 returns if, during the calendar year which includes the short taxable year of the organization, the organization is required to file at least 250 returns of any type, including information

returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns.

(e) *Example.* The following example illustrates the provisions of paragraph (d)(3) of this section. In the example, the organization is a calendar year taxpayer:

Example. In 2006, Organization T, with total assets in excess of $10 million, is required to file one Form 990, "*Return of Organization Exempt From Income Tax*," 200 Forms W–2, "*Wage and Tax Statement*," one Form 940, "*Employer's Annual Federal Unemployment (FUTA) Tax Return*," four Forms 941, "*Employer's QUARTERLY Federal Tax Return*," and 60 Forms 1099–MISC, "*Miscellaneous Income*." Because T is required to file 266 returns during the calendar year, T must file its 2006 Form 990 electronically.

(f) *Effective/applicability dates.* This section applies to any organization required to file Form 990 for a taxable year ending on or after December 31, 2006, that has total assets as of the end of the taxable year of $10 million or more. This section applies to any organization required to file Form 990–PF for taxable years ending on or after December 31, 2006, except for the application of the short year rules in paragraph (d)(3) of this section, which is applicable for taxable years ending on or after November 13, 2007.

§301.6033–4T [Removed]

Par. 12. Section 301.6033–4T is removed.

Par. 13. Section 301.6037–2 is added to read as follows:

§301.6037–2 Required use of magnetic media for returns of electing small business corporation.

(a) *Returns of electing small business corporation required on magnetic media.* An electing small business corporation required to file an electing small business return on Form 1120S, "*U.S. Income Tax Return for an S Corporation*," under §1.6037–1 of this chapter must file its Form 1120S on magnetic media if the small business corporation is required by the Internal Revenue Code and regulations to file at least 250 returns during the calendar year ending with or within its taxable year. Returns filed on magnetic media must be made in accordance with applicable revenue procedures, publications, forms, or instructions. In prescribing revenue procedures, publications, forms, or instructions, the Commissioner may direct the type of magnetic media filing. (See §601.601(d)(2) of this chapter).

(b) *Waiver.* The Commissioner may grant waivers of the requirements of this section in cases of undue hardship. A request for waiver must be made in accordance with applicable revenue procedures or publications. The waiver also will be subject to the terms and conditions regarding the method of filing as may be prescribed by the Commissioner.

(c) *Failure to file.* If an electing small business corporation fails to file a return on magnetic media when required to do so by this section, the corporation is deemed to have failed to file the return. (See section 6651 for the addition to tax for failure to file a return.) In determining whether there is reasonable cause for failure to file the return, §301.6651–1(c) and rules similar to the rules in §301.6724–1(c)(3) (undue economic hardship related to filing information returns on magnetic media) will apply.

(d) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term *magnetic media* means any magnetic media permitted under applicable regulations, revenue procedures, or publications. These generally include magnetic tape, tape cartridge, and diskette, as well as other media, such as electronic filing, specifically permitted under the applicable regulations, procedures, publications, forms, or instructions. (See §601.601(d)(2) of this chapter).

(2) *Corporation.* The term *corporation* means a corporation as defined in section 7701(a)(3).

(3) *Electing small business corporation return.* The term *electing small business corporation return* means a Form 1120S, "*U.S. Income Tax Return for an S Corporation*," along with all other related forms, schedules, and statements that are required to be attached to the Form 1120S, and all members of the Form 1120S series of returns, including amended and superseding returns.

(4) *Electing small business corporation.* The term *electing small business corporation* means an S corporation as defined in section 1361(a)(1).

(5) *Determination of 250 returns.* For purposes of this section, a corporation is required to file at least 250 returns if, during the calendar year ending with or within the taxable year of the corporation, the corporation is required to file at least 250 returns of any type, including information returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns. In the case of a short year return, a corporation is required to file at least 250 returns if, during the calendar year which includes the short taxable year of the corporation, the corporation is required to file at least 250 returns of any type, including information returns (for example, Forms W–2, Forms 1099), income tax returns, employment tax returns, and excise tax returns.

(e) *Example.* The following example illustrates the provisions of paragraph (d)(5) of this section. In the example, the corporation is a calendar year taxpayer:

Example. In 2007, Corporation S, an electing small business corporation with assets in excess of $10 million, is required to file one Form 1120S, "*U.S. Income Tax Return for an S Corporation*," 100 Forms W–2, "*Wage and Tax Statement*," 146 Forms 1099–DIV, "*Dividends and Distributions*," one Form 940, "Employer's Annual Federal Unemployment (FUTA) Tax Return," and four Forms 941, "*Employer's QUARTERLY Federal Tax Return*." Because S is required to file 252 returns during the calendar year, S is required to file its 2007 Form 1120S electronically.

(f) *Effective/applicability dates.* This section applies to returns of electing small business corporations that report total assets at the end of the corporation's taxable year that equal or exceed $10 million on Schedule L of Form 1120S for taxable years ending on or after December 31, 2006, except for the application of the short year rules in paragraph (d)(5) of this section, which is applicable for taxable years ending on or after November 13, 2007.

§301.6037–2T [Removed]

Par. 14. Section 301.6037–2T is removed.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

Approved November 6, 2007.

Eric Solomon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 13, 2007, 72 F.R. 63807)

Section 6041.—Information at Source

26 CFR 1.6041–1: Return of information as to payments of $600 or more.

A revenue rulilng provides that payments made by the U.S. Department of Veterans Affairs under the compensated work therapy program are exempt from federal income tax as veterans' benefits, and are not required to be reported on an information return. See Rev. Rul. 2007-69, page 1083.

Section 9037.—Payments to Eligible Candidates

A notice announces that the Department of Treasury will change the procedures for making payments from the Presidential Primary Matching Account, and will modify the regulations under section 9037 to reflect the changed procedures. See Notice 2007-96, page 1091.

Part III. Administrative, Procedural, and Miscellaneous

Effective Dates of Regulations Under Section 901

Notice 2007–95

PURPOSE

The purpose of this notice is to provide guidance relating to the effective dates of final regulations to be issued under section 901.

BACKGROUND

On August 3, 2006, the Internal Revenue Service (IRS) and Treasury Department issued proposed regulations that would provide guidance relating to the determination of who is considered to pay a foreign tax for purposes of section 901 and section 903. In particular, the proposed regulations would provide guidance under section 1.901–2(f) relating to the person on whom foreign law imposes legal liability for tax, including in the case of taxes imposed on the income of foreign consolidated groups and entities that have different classifications for U.S. and foreign tax law purposes. The proposed regulations provide that the final regulations will be effective for foreign taxes paid or accrued during taxable years of the taxpayer beginning on or after January 1, 2007. The IRS and Treasury Department have received written comments on the proposed regulations and held a hearing on the proposed regulations on October 13, 2006.

On March 29, 2007, the IRS and Treasury Department issued proposed regulations that would provide guidance under section 1.901–2(e)(5) relating to the amount of taxes paid for purposes of section 901. The proposed regulations would revise section 1.901–2(e)(5) in two ways. First, for purposes of determining compliance with section 1.901–2(e)(5), the proposed regulations would treat as a single taxpayer all foreign entities in which the same U.S. person has a direct or indirect interest of 80 percent or more (a "U.S.-owned foreign group"). Second, the proposed regulations would treat amounts paid to a foreign taxing authority as noncompulsory payments if those amounts are attributable to certain structured passive investments. The proposed regulations provide that the final regulations will be effective for foreign taxes paid or accrued during taxable years of the taxpayer ending on or after the date on which the regulations are finalized. The IRS and Treasury Department have received written comments on the proposed regulations and held a hearing on the proposed regulations on July 30, 2007.

DISCUSSION

The IRS and Treasury Department are considering the comments received on the two proposed regulations.

The IRS and Treasury Department intended to finalize the proposed section 1.901–2(f) regulations in 2007. However, the IRS and Treasury Department are still in the process of considering comments received on the proposed regulations and no longer expect to finalize these proposed regulations in 2007. Because the proposed regulations will not be finalized in 2007, the IRS and Treasury Department believe it is appropriate to revise the effective date for the regulations. Accordingly, the final regulations relating to the determination of who is considered to pay a foreign tax will be effective for taxable years beginning after the final regulations are published in the Federal Register.

In reviewing comments received, the IRS and Treasury Department have determined that the proposed change to section 1.901–2(e)(5) relating to U.S.-owned foreign groups may lead to inappropriate results in certain cases. The IRS and Treasury Department have therefore decided to sever the proposed rule for U.S.-owned foreign groups from the portion of the proposed section 1.901–2(e)(5) regulation addressing the treatment of foreign payments attributable to certain structured passive investment arrangements while continuing to study the appropriate treatment of U.S.-owned foreign groups. The IRS and Treasury Department also believe it is appropriate to revise the proposed effective date for the rules addressing the treatment of U.S.-owned foreign groups. Therefore, final regulations addressing U.S.-owned foreign groups will be effective for taxable years beginning after the final regulations are published in the Federal Register. For taxable years ending on or after March 29, 2007, and beginning on or before the date on which the final regulations are published, taxpayers may rely on the portion of the proposed regulations addressing U.S.-owned foreign groups. No inference is intended as to whether an amount paid by a foreign entity that is not a member of a U.S.-owned foreign group is a compulsory payment under existing section 1.901–2(e)(5).

The principal author of this notice is Bethany A. Ingwalson of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Bethany A. Ingwalson at (202) 622–3850 (not a toll-free call).

Payments From the Presidential Election Campaign Fund

Notice 2007–96

This notice supersedes Notice 96–13, 1996–1 C.B. 366, and announces that the Department of the Treasury (the Treasury) will change the procedures for making payments from the Presidential Primary Matching Payment Account (the Account). This notice also announces that the Treasury intends to modify the regulations under § 9037 of the Internal Revenue Code (26 U.S.C. § 9037 (2000)) to reflect the changed procedures.

Section 9006(a) established the Presidential Election Campaign Fund (the Fund) on the books of the U.S. Treasury. Section 9006(a) requires the Secretary to transfer to the Fund, from time to time, an amount equal to the individual taxpayer designations for the Fund under § 6096. See § 701.9006–1(a) of the Financing of Presidential Election Campaigns Regulations (26 C.F.R. § 701.9006–1(a) (2007)).

Section 701.9006–1(a) requires the Secretary to determine the amounts designated by individuals for the Fund at least once a month.

Section 9037(a) requires the Secretary to maintain within the Fund a separate account known as the Presidential Primary Matching Payment Account. The Secretary is required to deposit into the Account

amounts from the Fund after determining that there are amounts available and set aside in the Fund to make the payments described in § 9006 (payments for the general election) and § 9008 (payments for the presidential nominating conventions). The amounts in the Account are for presidential primary candidates who are certified for payments by the Federal Election Commission (the Commission).

Section 702.9037–2(a) provides that, except in the case of a shortfall described in § 702.9037–2(c), promptly after the end of each calendar month, but not before the beginning of the calendar year of a presidential election, the Secretary shall pay the amounts certified by the Commission in the preceding calendar month from the Account to the primary candidates.

Section 702.9037–2(c) provides that if the amount certified by the Commission for primary candidates in a calendar month exceeds the balance in the Account on the last day of the calendar month, the amount paid to a candidate for that month from the Account is determined by multiplying the amount certified by the Commission for the candidate during that month by the ratio of the balance in the Account on the last day of the calendar month over the total amount certified by the Commission for all the candidates during that month. Any amount certified by the Commission, but not paid to a candidate because of the operation of this shortfall rule, is treated as an amount certified by the Commission for that candidate during the succeeding calendar month. Section 702.9037–2(d) provides an example illustrating the shortfall rule of § 702.9037–2(c).

Notice 96–13 announced a change in the payment procedures contained in § 702.9037–2(c). The notice states that when the Account is in a shortfall position, the Secretary may make an additional payment between regular payment dates promptly after funds are available. Such payment is determined by multiplying the amount certified by the Commission for the candidate in month 1 by the ratio of the balance in the Account (but not to exceed the shortfall) on the 15th day of month 2 (or the first business day thereafter if the 15th is not a business day) over the total amount certified by the Commission for all the candidates in month 1.

Section 9037(b) contemplates that the Secretary should pay certified primary candidates as promptly as possible. Therefore, the Treasury will change the procedures, currently described in § 702.9037–2 and Notice 96–13, for making payments from the Account. Under the changed procedures, the Secretary may make payments as soon as funds become available in the Account rather than monthly (or, in the event of a shortfall, with an additional payment on the 15th of the next month, as required by Notice 96–13).

The Treasury intends to amend the regulations in § 702.9037–2 accordingly. As provided in Notice 96–13, the effective date of these amendments to the regulations will be February 2, 1996.

EFFECT ON OTHER DOCUMENTS

Notice 96–13 is superseded.

DRAFTING INFORMATION

The principal authors of this notice are Karla M. Meola and John Roman Faron of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Meola or Mr. Faron at (202) 622–4930 (not a toll-free call).

Alternative Fuel; Definition of Liquid Hydrocarbon

Notice 2007–97

SECTION 1. PURPOSE

This notice defines *liquid hydrocarbons derived from biomass* for purposes of the credits and payments provided for alternative fuel and alternative fuel mixtures under §§ 34, 6426, and 6427 of the Internal Revenue Code (the Code).

SECTION 2. BACKGROUND

(a) The credits and payments for alternative fuel and alternative fuel mixtures were added to the Code by § 11113(b) of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (Pub. L. 109–59). The credits and payment are allowed beginning October 1, 2006. Notice 2006–92, 2006–43 I.R.B. 774, provides general guidance on these credits and payments.

(b) Section 6426(d)(2) of the Code provides that the term *alternative fuel* means several specified products including (in § 6426(d)(2)(F)) liquid hydrocarbons derived from biomass (as defined in section 45K(c)(3)). Section 6426(d)(2) also provides that the term *alternative fuel* does not include ethanol, methanol, or biodiesel. *Biodiesel* is defined in section 40A(d)(1). Ethanol and methanol are included in the definition of alcohol in section 40(d)(1).

(c) Although the term *hydrocarbon* is not defined in the Code, the term is commonly defined as an organic compound containing only hydrogen and carbon. Treasury and the IRS have received numerous inquiries asking whether, for purposes of § 6426(d)(2)(F), the term *liquid hydrocarbons derived from biomass* can include liquids that contain oxygen, as well as hydrogen and carbon. Examples of liquids containing hydrogen, carbon, and oxygen include fish oil, liquids derived from other rendered fats, biodiesel, and alcohols such as ethanol and methanol.

(d) The fact that Congress specifically excluded ethanol, methanol, and biodiesel (all of which contain oxygen) from the definition of *liquid hydrocarbons derived from biomass* indicates that, for purposes of section 6426(d)(2)(F), *hydrocarbons* include substances that contain oxygen.

(e) The Senate Finance Committee has approved a technical correction that would clarify that any liquid fuel derived from biomass qualifies as an alternative fuel. The technical correction would also clarify that any fuel qualifying for an alcohol, biodiesel, or renewable diesel credit or payment does not qualify for the alternative fuel credit or payment.

SECTION 3. DEFINITION

(a) Except as provided in paragraph (b) of this section, *liquid hydrocarbons derived from biomass* are chemical compounds that are liquid when eligibility for the credit or payment is determined and are derived from any organic material, including oceanic and terrestrial crops and crop residues, and organic waste products that have a market value. For this purpose—

(1) Eligibility for the credit or payment for alternative fuel mixtures is determined when the alternative fuel mixture is produced; and

(2) Eligibility for the credit or payment for alternative fuel is determined when—

(i) Tax is imposed on the fuel by § 4041(a)(2); or

(ii) Tax would be imposed on the fuel but for the exemptions provided by § 4041 (b), (f), (g), or (h).

(b) *Liquid hydrocarbons derived from biomass* do not include—

(1) Ethanol, methanol, or biodiesel; or

(2) Oil, natural gas, coal (including lignite) or any product of oil, natural gas, or coal.

SECTION 4. EFFECT OF EXPECTED TECHNICAL CORRECTION

Under current law, ethanol and methanol are excluded from the definition of alternative fuels qualifying for the alternative fuel credit or payment. The technical correction approved by the Senate Finance Committee would provide, in addition, that no other alcohol fuel is eligible for an alternative fuel credit or payment. If this technical correction is enacted it will be retroactive to October 1, 2006. Accordingly, if the technical correction is enacted and a taxpayer was allowed an alternative fuel credit or payment with respect to any alcohol fuel before the date of enactment, the taxpayer will be required to repay the amount of such credit or payment with interest.

SECTION 5. EFFECTIVE DATE

This notice is effective October 1, 2006.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is DeAnn Malone of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, please contact DeAnn Malone at (202) 622–3130 (not a toll-free call).

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 1167, General Rules and Specifications for Substitute Forms and Schedules.

Rev. Proc. 2007-68

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Part 1
Introduction to Substitute Forms

Section 1.1 – Overview of Revenue Procedure 2007-68

1.1.1
Purpose

The purpose of this revenue procedure is to provide guidelines and general requirements for the development, printing, and approval of substitute tax forms. Approval will be based on these guidelines. After review and approval, submitted forms will be accepted as substitutes for official IRS forms.

1.1.2
Unique Forms

Certain unique specialized forms require the use of other additional publications to supplement this publication. See Part 4.

1.1.3
Scope

The IRS accepts quality substitute tax forms that are consistent with the official forms and have no adverse impact on our processing. The IRS Substitute Forms Unit administers the formal acceptance and processing of these forms nationwide. While this program deals primarily with paper documents, it also reviews for approval other processing and filing forms such as those used in electronic filing.

Only those substitute forms that comply fully with the requirements are acceptable. This revenue procedure is updated as required to reflect pertinent tax year form changes and to meet processing and/or legislative requirements.

1.1.4
Forms Covered by This Revenue Procedure

The following types of forms are covered by this revenue procedure:

- IRS tax forms and their related schedules,
- Worksheets as they appear in instruction packages,
- Applications for permission to file returns electronically and forms used as required documentation for electronically filed returns,
- Powers of Attorney,
- Over-the-counter estimated tax payment vouchers, and
- Forms and schedules relating to partnerships, exempt organizations, and employee plans.

1.1.5
Forms Not Covered by This Revenue Procedure

The following types of forms are not covered by this revenue procedure:

- W-2 and W-3 (see Publication 1141 for information on these forms),
- W-2c and W-3c (see Publication 1223 for information on these forms),
- 941 and Schedule B (Form 941) (see Publication 4436 for information on these forms),
- 1096, 1098 series, 1099 series, 5498 series, W-2G, and 1042-S (see Publication 1179 for information on these forms),
- Federal Tax Deposit (FTD) coupons, which may not be reproduced,
- Forms 1040-ES (OCR) and 1041-ES (OCR), which may not be reproduced,
- Forms 5500, 5500-EZ, and associated schedules (see the Department of Labor website at *www.dol.gov* for information on these forms),
- Forms 8717 and 8905, bar-coded forms requiring separate approval,
- FinCEN forms, TD F 90-22 forms, and Form 8300,
- Requests for information or documentation initiated by the IRS,
- Forms used internally by the IRS,
- State tax forms,

- Forms developed outside the IRS, and
- General Instructions and Specific Instructions (not reviewed by the Substitute Forms Program Unit).

Section 1.2 – IRS Contacts

1.2.1 Where To Send Substitute Forms

Send your substitute forms for approval to the following offices (do not send forms with taxpayer data):

Form	Office and Address
All FinCEN family of forms, TD F 90-22 family of forms, and Form 8300	Enterprise Computing Center - Detroit (ECC-D) BSA Compliance Branch P.O. Box 32063 Detroit, MI 48232-0063
5500, 5500-EZ, and Schedules A through E, G, H, I, R, and SSA for Form 5500	Check EFAST information at the Department of Labor's website at *www.efast.dol.gov*
8717 and 8905	*Joanna.H.Weber@irs.gov*
Software developer vouchers (See Sections 2.3.7 - 2.3.9)	Internal Revenue Service Attn: Doris Bethea, C5-163 5000 Ellin Rd. Lanham, MD 20706 *Doris.E.Bethea@irs.gov*
All others (except W-2, W-2c, W-3, W-3c, 941, Schedule B (Form 941), 1096, 1098, 1099, 5498, W-2G, and 1042-S) covered by this publication	Internal Revenue Service Attn: Substitute Forms Program SE:W:CAR:MP:T:T:SP 1111 Constitution Avenue, NW Room 6526 Washington, DC 20224

In addition, the Substitute Forms Program Unit can be contacted via email at *Substituteforms@irs.gov*. Please include "PDF Submissions" on the subject line.

For questions about Forms W-2 and W-3, refer to IRS Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3. For Forms W-2c and W-3c, refer to IRS Publication 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c. For Forms 941 and Schedule B (Form 941), refer to IRS Publication 4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941). For Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S, refer to IRS Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S.

Section 1.3 – What's New

1.3.1 What's New

The following changes have been made to the Revenue Procedure for tax year 2007.

- We have implemented a new policy that lets you assume that your email substitute form submission has been approved if you do not hear from us within 20 business days. Starting September 4, 2007, we began acknowledging each email submission with a return email outlining the policy. This policy does not apply to forms submitted by paper or fax. Also

this policy does not apply to new forms issued by the IRS that you have submitted for the first time, nor does it apply to forms that the IRS has substantially changed during the year. See Section 1.5.2 for more details.

- **New email address.** Due to the new policy, please submit your email form submissions to *Substituteforms@irs.gov* instead of **taxforms@irs.gov*.
- You can now send 25 instead of 50 sample substitute forms for approval of software vendor vouchers. See Section 2.3.9.
- The room number in the address of the Substitute Forms Unit has changed to Room 6526.
- We have revised Section 7.1, which deals with substitute Schedules K-1.
- We have revised Section 8.1, which deals with electronic filing.
- We have slightly revised the sample check sheet in Exhibit D.
- The Exhibits section has been changed and updated.
- We made editorial changes as needed.

Section 1.4 – Definitions

1.4.1
Substitute Form

A tax form (or related schedule) that differs in any way from the official version and is intended to replace the form that is printed and distributed by the IRS. This term also covers those approved substitute forms exhibited in this revenue procedure.

1.4.2
Printed/Preprinted Form

A form produced using conventional printing processes, or a printed form which has been reproduced by photocopying or a similar process.

1.4.3
Preprinted Pin-Fed Form

A printed form that has marginal perforations for use with automated and high-speed printing equipment.

1.4.4
Computer Prepared Substitute Form

A preprinted form in which the taxpayer's tax entry information has been inserted by a computer, computer printer, or other computer-type equipment.

1.4.5
Computer Generated Substitute Tax Return or Form

A tax return or form that is entirely designed and printed using a computer printer such as a laser printer, etc., on plain white paper. This return or form must conform to the physical layout of the corresponding IRS form, although the typeface may differ. The text should match the text on the officially printed form as closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis.

Exception. All jurats (perjury statements) must be reproduced verbatim.

1.4.6
Manually Prepared Form

A preprinted reproduced form in which the taxpayer's tax entry information is entered by an individual using a pen, pencil, typewriter, or other non-automated equipment.

1.4.7
Graphics

Parts of a printed tax form that are not tax amount entries or required text. Examples of graphics are line numbers, captions, shadings, special indicators, borders, rules, and strokes created by typesetting, photographics, photocomposition, etc.

1.4.8
Acceptable Reproduced Form

A legible photocopy of an original form.

1.4.9
Supporting Statement (Supplemental Schedule)

A document providing detailed information to support a line entry on an official or approved substitute form and filed with (attached to) a tax return.

Note. A supporting statement is not a tax form and does not take the place of an official form.

1.4.10
Specific Form Terms

The following specific terms are used throughout this revenue procedure in reference to all substitute forms: format, sequence, line reference, item caption, and data entry field.

1.4.11
Format

The overall physical arrangement and general layout of a substitute form.

1.4.12
Sequence

Sequence is an integral part of the total format requirement. The substitute form should show the same numeric and logical placement order of data, as shown on the official form.

1.4.13
Line Reference

The line numbers, letters, or alphanumerics used to identify each captioned line on an official form. These line references are printed to the immediate left of each caption and/or data entry field.

1.4.14
Item Caption

The text on each line of a form, which identifies the data required.

1.4.15
Data Entry Field

Designated areas for the entry of data such as dollar amounts, quantities, responses and checkboxes.

1.4.16
Advance Draft

A draft version of a new or revised form may be posted to the IRS website for information purposes. Substitute forms may be submitted based on these advance drafts, but any submitter that receives forms approval based on these early drafts is responsible for monitoring and revising forms to mirror any revisions in the final forms provided by the IRS.

1.4.17
Approval

Generally, approval could be in writing or assumed after 20 business days from our receipt for forms that have not been substantially changed by the IRS. Also, this does not apply to newly created or substantially revised IRS forms.

Section 1.5 – Agreement

1.5.1
Important Stipulation of This Revenue Procedure

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure agrees to the following stipulations.

- The IRS presumes that any required changes are made in accordance with these procedures and will not be disruptive to the processing of the tax return.
- Should any of the changes be disruptive to the IRS's processing of the tax return, the person or company agrees to accept the determination of the IRS as to whether the form may continue to be filed.
- The person or company agrees to work with the IRS in correcting noted deficiencies. Notification of deficiencies may be made by any combination of fax, letter, email, or phone contact and may include the request for the re-submission of unacceptable forms.

1.5.2
Response Policy and Stipulations

We will inform you when the Substitute Forms Unit has received your form submission. You can consider your submission approved if you do not receive a response from us within 20 business days. If we anticipate a problem reviewing your submission within the 20 business day period, we will send an interim email notifying you of an extended period of approval.

Once the substitute forms have been approved by the IRS, you can release them after the final versions of the forms have been issued by the IRS. Before releasing the forms, you are responsible for updating forms approved as draft and for making form changes we requested.

The policy has the following stipulations.

- This 20-day policy applies to electronic submissions only. It does not apply to substitute forms submitted by paper or fax.
- The policy applies to submissions of 15 or fewer items. Submissions of more than 15 may delay processing.
- If we receive a large number of your submissions within a short period of time, processing may be delayed.
- There could be delays in processing if we find significant errors in your submission. We will send you an interim email in that case.
- If we anticipate any problems in processing your submission within the 20-day period, we will send you an interim email on or about the 15th business day.
- If subsequent to the 20-day period we discover a significant inaccuracy, we reserve the right to inform you and will require that changes be made to correct the error.
- It does not apply to substantially revised forms nor to new forms created by the IRS for which you have made your first submission.

Part 2
General Guidelines for Submissions and Approvals

Section 2.1 – General Specifications for Approval

2.1.1
Overview

If you produce any tax forms using IRS guidelines on permitted changes, you can generate your own substitutes without further approval. If your changes are more extensive, you must get IRS approval before using substitute forms. More extensive changes can include the use of typefaces and sizes other than those found on the official form and the condensing of line item descriptions to save space.

Note. The 20-day turnaround policy may not apply to extensive changes.

2.1.2
Email Submissions

The Substitute Forms Program accepts substitute forms submissions via email. The email address is *Substituteforms@irs.gov* . Please include the term "PDF Submissions" on the subject line.

Follow these guidelines.

- Your submission should include all the forms you wish to submit in one attached pdf file. **Do not email each form individually.**
- An approval check sheet listing the forms you are submitting should always be included in the pdf file along with the forms. See a sample check sheet in Exhibit D.
- Small (fewer than 15 forms), rather than large, submissions should expedite processing. The maximum submission should contain 15 forms.
- Emailing pdf submissions will not expedite review and approval. The pdf submissions will be assigned a control number and put in queue along with mailed-in paper submissions.
- Optimize pdf files before submitting.
- The maximum allowable email attachment is 2.5 megabytes.
- The Substitute Forms Unit accepts zip files.
- To alleviate delays during the peak time of September through December, submit advance draft forms as early as possible.

If the guidelines are not followed, you may need to resubmit.

In addition to submitting forms via email, you may continue to send your submissions to:

Internal Revenue Service
SE:W:CAR:MP:T:T:SP
Attn: Substitute Forms Program
1111 Constitution Avenue, NW
Room 6526
Washington, DC 20224

2.1.3
Expediting the Process

Follow these basic guidelines for expediting the process.

- Always include a check sheet for the Substitute Forms Unit's response.
- Follow Publication 1167 for general substitute form guidelines. Follow the specialized publications produced by the Substitute Forms Unit for other specific forms.

- To spread out the workload, send in draft versions of substitute forms when they are posted.

  Note. Be sure to make any changes to approved drafts before releasing final versions.

2.1.4
Schedules

Schedules are considered to be an integral part of a complete tax return. A schedule may be included as part of a form or printed separately.

2.1.5
Examples of Schedules That Must Be Submitted with the Return

Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, is an example of this situation. Its Schedules A through U have pages numbered as part of the basic return. For Form 706 to be considered for approval, the entire form including Schedules A through U must be submitted.

2.1.6
Examples of Schedules That Can Be Submitted Separately

However, Schedules 1, 2, and 3 of Form 1040A are examples of schedules that can be submitted separately. Although printed by the IRS as a supplement to Form 1040A, none of these schedules are required to be filed with Form 1040A. These schedules may be separated from Form 1040A and submitted as substitute forms.

2.1.7
Use and Distribution of Unapproved Forms

The IRS is continuing a program to identify and contact tax return preparers, forms developers, and software publishers who use or distribute unapproved forms that do not conform to this revenue procedure. The use of unapproved forms hinders the processing of the returns.

Section 2.2 – Highlights of Permitted Changes and Requirements

2.2.1
Methods of Reproducing Internal Revenue Service Forms

Official IRS tax forms are supplied by the IRS. These forms may be provided in the taxpayer's tax package or over-the-counter. Forms can also be picked up at many IRS offices, post offices, or libraries, and are available on CD and online at *www.irs.gov*.

There are methods of reproducing IRS printed tax forms suitable for use as substitutes without prior approval.

- You can photocopy most tax forms and use them instead of the official ones. The entire substitute form, including entries, must be legible.
- You can reproduce any current tax form as cut sheets, snap sets, and marginally punched, pin-fed forms as long as you use an official IRS version as the master copy.
- You can reproduce a form that requires a signature as a valid substitute form. Many tax forms (including returns) have a taxpayer signature requirement as part of the form layout. The jurat/perjury statement/signature line areas must be retained and worded exactly as on the official form. The requirement for a signature, by itself, does not prohibit a tax form from being properly computer-generated.

2.3.1
Overview

All payment vouchers (Forms 940-V, 940-EZ(V), 941-V, 943-V, 945-V, 1040-V, and 2290-V) must be reproduced in conjunction with their forms. Substitute vouchers must be the same size as the officially printed vouchers. Vouchers that are prepared for printing on a laser printer may include a scan line.

2.3.2
Scan Line Specifications

	NNNNNNNNN	AA	XXXX	NN	N	NNNNNN	NNN
Item:	A	B	C	D	E	F	G

A. Social Security Number/Employer Identification Number (SSN/EIN) has 9 numeric (N) spaces.

B. Check Digits have 2 alpha (A) spaces.

C. Name Control has 4 alphanumeric (X) spaces.

D. Master File Tax (MFT) Code has 2 numeric (N) spaces (see below).

E. Taxpayer Identification Number (TIN) Type has 1 numeric (N) space (see below).

F. Tax Period has 6 numeric (N) spaces in year/month format (YYYYMM).

G. Transaction Code has 3 numeric (N) spaces.

2.3.3
MFT Code

Code Number for Forms:

- 1040 (family) – 30,
- 940/940-EZ – 10,
- 941 – 01,
- 943 – 11,
- 945 – 16, and
- 2290 – 60.

2.3.4
TIN Type

Type Number for:

- Form 1040 (family) – 0, and
- Forms 940, 940-EZ, 941, 943, 945, and 2290 – 2.

2.3.5
Voucher Size

The voucher size must be exactly 8.0″ x 3.25″ (Forms 1040-ES and 1041-ES must be 7.625″ x 3.0″). The document scan line must be vertically positioned 0.25 inches from the bottom of the scan line to the bottom of the voucher. The last character on the right of the scan line must be placed 3.5 inches from the right leading edge of the document. The minimum required horizontal clear space between characters is .014 inches. The line to be scanned must have a clear band 0.25 inches in height from top to bottom of the scan line, and from border to border of the document. "Clear band" means no printing except for dropout ink.

2.3.6
Print and Paper Weight

Vouchers must be imaged in black ink using OCR A, OCR B, or Courier 10. These fonts may not be mixed in the scan line. The horizontal character pitch is 10 CPI. The preferred paper weight is 20 to 24 pound OCR bond.

2.3.7
Specifications for Software Developers

Certain vouchers may be reproduced for use in the IRS lockbox system. These include the 1040-V, 1040-ES, the 940 family, and 2290 vouchers. Software developers must follow these specific guidelines to produce scannable vouchers strictly for lockbox purposes. Also see Exhibit C.

- The total depth must be 3.25 inches.
- The scan line must be .5 inches from the bottom edge and 1.75 inches from the left edge of the voucher and left-justified.
- Software developers vouchers must be 8.5 inches wide (instead of 8 inches with a cut line). Therefore, no vertical cut line is required.
- Scan line positioning must be exact.
- Do not use the over-the-counter format voucher and add the scan line to it.
- All scanned data must be in 12-point OCR A font.
- The 4-digit NACTP ID code should be placed under the payment indicator arrow.
- Windowed envelopes must not display the scan line in order to avoid disclosure and privacy issues.

Note. All software developers must ensure that their software uses OCR A font so taxpayers will be able to print the vouchers in the correct font.

2.3.8
Specific Line Positions

Follow these line specifications for entering taxpayer data in the lockbox vouchers.

	Start Row	Start Column	Width	End Column
Line Specifications for Taxpayer Data:				
Taxpayer Name	56	6	36	41
Taxpayer Address, Apt.	57	6	36	41
Taxpayer City, State, ZIP	58	6	36	41
Line Specifications for Mail To Data:				
Mail Address	57	43	38	80
Mail City, State, ZIP	58	43	38	80
Line Specifications for:				
Scan Line	63	26	n/a	n/a

2.3.9
How to Get Approval

To receive approval, please send 25 voucher samples yearly, by December 10, for testing to the following address.

Internal Revenue Service
Attn: Doris Bethea, C5-163
5000 Ellin Rd.
Lanham, MD 20706

For further information, contact either Doris Bethea, *Doris.E.Bethea@irs.gov*, at 202-283-0218.

Section 2.4 – Restrictions on Changes

2.4.1
What You Cannot Do to Forms Suitable for Substitute Tax Forms

You cannot, without prior IRS approval, change any IRS tax form or use your own (non-approved) versions including graphics, unless specifically permitted by this revenue procedure. See Sections 2.5.7 to 2.5.11.

You cannot adjust any of the graphics on Forms 1040, 1040A, and 1040EZ (except in those areas specified in Part 5 of this revenue procedure) without prior approval from the IRS Substitute Forms Unit.

You cannot use your own preprinted label on tax returns filed with the IRS unless you fully comply with the criteria specified in Section 3.6.3 on the use of pre-addressed IRS labels.

Note. The 20-day turnaround policy may not apply to extensive changes.

Section 2.5 – Guidelines for Obtaining IRS Approval

2.5.1
Basic Requirements

Preparers who submit substitute privately designed, privately printed, computer generated, or computer prepared tax forms must develop these substitutes using the guidelines established in this part. These forms, unless there is an exception outlined by the revenue procedure, must be approved by the IRS before being filed.

2.5.2
Conditional Approval Based on Advanced Drafts

The IRS cannot grant final approval of your substitute form until the official form has been published. However, the IRS posts advance draft forms in the "Tax Professionals" area of its website at:

www.irs.gov/taxpros/lists/0,,id=97782,00.html

We encourage submission of proposed substitutes of these advance draft forms and will grant conditional approval based solely on these early drafts. These advance drafts are subject to significant change before forms are finalized. If these advance drafts are used as the basis for your substitute forms, you will be responsible for subsequently updating your final forms to agree with the final official version. These revisions need not be resubmitted for further approval.

Note. Approval of forms based on advance drafts will not be granted after the final version of an official form is published.

2.5.3
Submission Procedures

Follow these general guidelines when submitting substitute forms for approval.

- Any alteration of forms must be within the limits acceptable to the IRS. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.
- When approval of any substitute form (other than those exceptions specified in Part 1, Section 1.2 – IRS Contacts) is requested, a sample of the proposed substitute form should be forwarded for consideration via email or by letter to the Substitute Forms Unit at the address shown in Section 1.2.1.
- Schedules and forms (for example, Forms 3468, 4136, etc.) that can be used with more than one type of return (for example, 1040, 1041, 1120, etc.) should be submitted only once for approval, regardless of the number of different tax returns with which they may be associated. Also, all pages of multi-page forms or returns should be submitted in the same package.

2.5.4
Approving Offices

Because only the Substitute Forms Unit is authorized to approve substitute forms, unnecessary delays may occur if forms are sent to the wrong office. You may receive an interim letter about the delay. The Substitute Forms Unit may then coordinate the response with the originator responsible for revising that particular form. Such coordination may include allowing the originator to officially approve the form. No IRS office is authorized to allow deviations from this revenue procedure.

2.5.5
IRS Review of Software Programs, etc.

The IRS does not review or approve the logic of specific software programs, nor does the IRS confirm the calculations on the forms produced by these programs. The accuracy of the program remains the responsibility of the software package developer, distributor, or user.

The Substitute Forms Unit is primarily concerned with the pre-filing quality review of the final forms that are expected to be processed by IRS field offices. For this purpose, you should submit forms without including any taxpayer information such as names, addresses, monetary amounts, etc.

2.5.6
When To Send Proposed Substitutes

Proposed substitutes, which are required to be submitted per this revenue procedure, should be sent as much in advance of the filing period as possible. This is to allow adequate time for analysis and response.

2.5.7
Accompanying Statement

When submitting sample substitutes, you should include an accompanying statement that lists each form number and its changes from the official form (position, arrangement, appearance, line numbers, additions, deletions, etc.). With each of the items you should include a detailed reason for the change.

When requesting approval, please include a check sheet. Check sheets expedite the approval process. The check sheet may look like the example in Exhibit D displayed in the back of this procedure or may be one of your own design. Please include your fax number on the check sheet.

2.5.8 Approval/Non-Approval Notice

The Substitute Forms Unit will fax the check sheet or an approval letter to the originator if a fax number has been provided, unless:

- The requester has asked for an email response or for a formal letter, or
- Significant corrections to the submitted forms are required.

Notice of approval may impose qualifications before using the substitutes. Notices of unapproved forms may specify the changes required for approval and require re-submission of the form(s) in question. When appropriate, you will be contacted by telephone.

2.5.9 Duration of Approval

Most signature tax returns and many of their schedules and related forms have the tax (liability) year printed in the upper right corner. Approvals for these annual forms are usually good for one calendar year (January through December of the year of filing). Quarterly tax forms in the 940 series and Form 720 require approval for any quarter in which the form has been revised.

Because changes are usually made to an annual form every year, each new filing season generally requires a new submission of a substitute form. Very rarely is updating the preprinted year the only change made to an annual form.

2.5.10 Limited Continued Use of an Approved Change

Limited changes approved for one tax year may be allowed for the same form in the following tax year. Examples are the use of abbreviated words, revised form spacing, compressed text lines, and shortened captions, etc., which do not change the integrity of lines or text on the official forms.

If substantial changes are made to the form, new substitutes must be submitted for approval. If only minor editorial changes are made to the form, it is not subject to review. It is the responsibility of each vendor who has been granted permission to use substitute forms to monitor and revise forms to mirror any revisions to official forms made by the Service. If there are any questions, please contact the Substitute Forms Unit.

2.5.11 When Approval Is Not Required

If you received approval for a specific change on a form last year, you may make the same change this year if the item is still present on the official form.

- The new substitute form does not have to be submitted to the IRS and approval based on that change is not required.
- However, the new substitute form must conform to the official current year IRS form in other respects: date, Office of Management and Budget (OMB) approval number, attachment sequence number, Paperwork Reduction Act Notice statement, arrangement, item caption, line number, line reference, data sequence, etc.
- The new substitute form must also comply with changes to the guidelines in this revenue procedure. The procedure may have eliminated, added to, or otherwise changed the guideline(s) that affected the change approved in the prior year.
- An approved change is authorized only for the period from a prior tax year substitute form to a current tax year substitute form.

Exception. Forms with temporary, limited, or interim approvals (or with approvals that state a change is not allowed in any other tax year) are subject to review in subsequent years.

2.5.12 Continuous-Use Forms

Forms without preprinted tax years are called "continuous-use" forms. Continuous-use forms are revised when a legislative change affects the form or a change will facilitate processing. These forms frequently have revision dates that are valid for longer than one year.

2.5.13 IRS Website Posting Schedule

A schedule of print dates (for annual and quarterly forms) and most current revision dates (for continuous-use forms) are maintained on the IRS website. The Tax Products Posting Schedule can be found at *www.irs.gov/formspubs/article/0,,id=103641,00.html*. See Section 4.2.2.

2.5.14 Required Copies

Generally, you must send us one copy of each form being submitted for approval. However, if you are producing forms for different computer systems (for example, IBM compatible vs. Macintosh) or different types of printers (for example, laser vs. inkjet), and these forms differ **significantly** in appearance, submit one copy for each type of system or printer.

2.5.15 Requestor's Responsibility

Following receipt of an initial approval for a substitute forms package or a software output program to print substitute forms, it is the responsibility of the originator (designer or distributor) to provide client firms or individuals with forms that meet the IRS's requirements for continuing acceptability. Examples of this responsibility include:

- Using the prescribed print paper, font size, legibility, state tax data deletion, etc., and
- Informing all users of substitute forms of the legal requirements of the Paperwork Reduction Act Notice, which is generally found in the instructions for the official IRS forms.

2.5.16 Source Code

The Substitute Forms Unit will assign a unique source code to each firm that submits substitute paper forms for approval. This source code will be a permanent identifier that must be used on every submission by a particular firm.

The source code consists of three alpha characters and should generally be printed at the bottom left margin area on the first page of every approved substitute form.

Section 2.6 – Office of Management and Budget (OMB) Requirements for All Substitute Forms

2.6.1 OMB Requirements for All Substitute Forms

There are legal requirements of the Paperwork Reduction Act of 1995 (The Act). Public Law 104-13 requires the following.

- OMB approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in the upper right corner) the OMB number, if assigned.
- Each IRS form (or its instructions) states why the IRS needs the information, how it will be used, and whether or not the information is required to be furnished to the IRS.

This information must be provided to every user of official or substitute IRS forms or instructions.

2.6.2
Application of the Paperwork Reduction Act

On forms that have been assigned OMB numbers:

- All substitute forms must contain in the upper right corner the OMB number that is on the official form, and
- The required format is: OMB No. 1545-XXXX (Preferred) or OMB # 1545-XXXX (Acceptable).

2.6.3
Required Explanation to Users

You must inform the users of your substitute forms of the IRS use and collection requirements stated in the instructions for official IRS forms.

- If you provide your users or customers with the official IRS instructions, each form must retain either the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice), or a reference to it as the IRS does on the official forms (usually in the lower left corner of the forms).
- This notice reads, in part, "We ask for the information on this form to carry out the Internal Revenue laws of the United States...."

Note. If no IRS instructions are provided to users of your forms, the exact text of the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice) must be furnished separately or on the form.

2.6.4
Finding the OMB Number and Paperwork Reduction Act Notice

The OMB number and the Paperwork Reduction Act Notice, or references to it, may be found printed on an official form (or its instructions). The number and the notice are included on the official paper format and in other formats produced by the IRS (for example, compact disc (CD) or Internet download).

Part 3
Physical Aspects and Requirements

Section 3.1 – General Guidelines for Substitute Forms

3.1.1
General Information

The official form is the standard. Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. The IRS provides several means of obtaining the most frequently used tax forms. These include the Internet and CD (see Part 4).

3.1.2
Design

Each form must follow the design of the official form as to format arrangement, item caption, line numbers, line references, and sequence.

3.1.3
State Tax Information Prohibited

Generally, state tax information must not appear on the federal tax return, associated form, or schedule that is filed with the IRS. Exceptions occur when amounts are claimed on, or required by, the federal return (for example, state and local income taxes, on Schedule A of Form 1040).

3.1.4
Vertical Alignment of Amount Fields

IF a form is to be...	THEN...
Manually prepared	1. The entry column must have a vertical line or some type of indicator in the amount field to separate dollars from cents. 2. The cents column must be at least 3/10″ wide.
Computer generated	1. Vertically align the amount entry fields where possible. 2. Use one of the following amount formats: a) 0,000,000, or b) 0,000,000.00.
Computer prepared	1. You may remove the vertical line in the amount field that separates dollars from cents. 2. Use one of the following amount formats: a) 0,000,000, or b) 0,000,000.00.

3.1.5
Attachment Sequence Number

Many individual income tax forms have a required "attachment sequence number" located just below the year designation in the upper right corner of the form. The IRS uses this number to indicate the order in which forms are to be attached to the tax return for processing. Some of the attachment sequence numbers may change from year to year.

The following applies to computer prepared forms.

- The sequence number may be printed in no less than 12-point boldface type and centered below the form's year designation.
- The sequence number may also be placed following the year designation for the tax form and separated with an asterisk.
- The actual number may be printed without labeling it the "Attachment Sequence Number."

3.1.6
Assembly of Forms

When developing software or forms for use by others, please inform your customers/clients that the order in which the forms are arranged may affect the processing of the package. A return must be arranged in the order indicated below.

IF the form is...	THEN the sequence is...
1040	• Form 1040, and • Schedules and forms in attachment sequence number order.
Any other tax return (Form 1120, 1120S, 1065, 1041, etc.)	• The tax returns, • Directly associated schedules (Schedule D, etc.), • Directly associated forms, • Additional schedules in alphabetical order, and • Additional forms in numerical order.

Supporting statements should then follow in the same sequence as the forms they support. Additional information required should be attached last.

In this way, the forms are received in the order in which they must be processed. If you do not send returns to us in order, processing may be delayed.

3.1.7 Paid Preparer's Information and Signature Area

On Forms 1040EZ, 1040A, 1040, and 1120, etc., the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer's address area without prior approval. This applies to other tax forms as well.

3.1.8 Some Common Reasons for Requiring Changes to Substitute Forms

Some reasons that substitute form submissions may require changes include the following.

- Failing to preprint certain amounts in entry spaces.
- Shading areas incorrectly.
- Failing to include a reference to the location of the Paperwork Reduction Act Notice.
- Not including parentheses for losses.
- Not including "Attach Statement" when appropriate.
- Including line references or entry spaces that don't match the official form.
- Printing text that is different from the official form.
- Altering the jurat.

Section 3.2 – Paper

3.2.1 Paper Content

The paper must be:

- Chemical wood writing paper that is equal to or better than the quality used for the official form,
- At least 18 pound (17″ x 22″, 500 sheets), or
- At least 50 pound offset book (25″ x 38″, 500 sheets).

3.2.2 Paper with Chemical Transfer Properties

There are several kinds of paper prohibited for substitute forms. These are:

1. Carbon-bonded paper, and
2. Chemical transfer paper except when the following specifications are met:
   a. Each ply within the chemical transfer set of forms must be labeled, and
   b. Only the top ply (ply one and white in color), the one that contains chemical on the back only (coated back), may be filed with the IRS.

3.2.3 Example

A set containing three plies would be constructed as follows: ply one (coated back), "Federal Return, File with IRS"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

The file designation, "Federal Return, File with IRS" for ply one, must be printed in the bottom right margin (just below the last line of the form) in 12-point boldface type.

It is not mandatory, but recommended, that the file designation "Federal Return, File with IRS" be printed in a contrasting ink for visual emphasis.

3.2.4
Carbon Paper

Do not attach any carbon paper to any return you file with the IRS.

3.2.5
Paper and Ink Color

We prefer that the color and opacity of paper substantially duplicates that of the original form. This means that your substitute must be printed in black ink and may be on white or on the colored paper the IRS form is printed on. Forms 1040A and 1040 substitute reproductions may be in black ink without the colored shading. The only exception to this rule is Form 1041-ES, which should always be printed with a very light gray shading in the color screened area. This is necessary to assist us in expeditiously separating this form from the very similar Form 1040-ES.

3.2.6
Page Size

Substitute or reproduced forms and computer prepared/generated substitutes may be the same size as the official form or they may be the standard commercial size (8½″ x 11″). The thickness of the stock cannot be less than .003 inches.

Section 3.3 – Printing

3.3.1
Printing Medium

The private printing of all substitute tax forms must be by conventional printing processes, photocopying, computer graphics, or similar reproduction processes.

3.3.2
Legibility

All forms must have a high standard of legibility as to printing, reproduction, and fill-in matter. Entries of taxpayer data may be no smaller than eight points. The IRS reserves the right to reject those with poor legibility. The ink and printing method used must ensure that no part of a form (including text, graphics, data entries, etc.) develops "smears" or similar quality deterioration. This standard must be followed for any subsequent copies or reproductions made from an approved master substitute form, either during preparation or during IRS processing.

3.3.3
Type Font

Many federal tax forms are printed using "Helvetica" as the basic type font. We request that you use this type font when composing substitute forms.

3.3.4
Print Spacing

Substitute forms should be printed using a 6 lines/inch vertical print option. They should also be printed horizontally in 10 pitch pica (that is, 10 print characters per inch) or 12 pitch elite (that is, 12 print positions per inch).

3.3.5
Image Size

The image size of a printed substitute form should be as close as possible to that of the official form. You may omit any text on both computer prepared and computer generated forms that is solely instructional.

3.3.6
Title Area Changes

To allow a large top margin for marginal printing and more lines per page, the title line(s) for all substitute forms (not including the form's year designation and sequence number, when present), may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury, Internal Revenue Service" and all reference to instructions in the form's title area.

3.3.7
Remove Government Printing Office Symbol and IRS Catalog Number

When privately printing substitute tax forms, the Government Printing Office (GPO) symbol and/or jacket number must be removed. In the same place using the same type size, print the Employer Identification Number (EIN) of the printer or designer or the IRS assigned source code. (We prefer this last number be printed in the lower left area of the first page of each form.) Also, remove the IRS Catalog Number (Cat. No.) and the recycle symbol if the substitute is not produced on recycled paper.

3.3.8
Printing on One Side of Paper

While it is preferred that both sides of the paper be used for substitutes and reproduced forms, resulting in the same page arrangement as that of the official form or schedule, the IRS will accept your forms if only one side of the paper is used.

3.3.9
Photocopy Equipment

The IRS does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms. Photocopies of forms must be entirely legible and satisfy the conditions stated in this and other revenue procedures.

3.3.10
Reproductions

Reproductions of official forms and substitute forms that do not meet the requirements of this revenue procedure may not be filed instead of the official forms. Illegible photocopies are subject to being returned to the filer for re-submission of legible copies.

3.3.11
Removal of Instructions

Generally, you may remove references to instructions. No prior approval is needed. However in some instances, you may be requested to include references to instructions.

Exception. The words "For Paperwork Reduction Act Notice, see instructions" must be retained or a similar statement indicating the location of the Notice must be provided on each form.

Section 3.4 – Margins

3.4.1
Margin Size

The format of a reproduced tax form when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for IRS employees to make necessary entries on the form during processing.

- A 1/2-inch to 1/4-inch margin must be maintained across the top, bottom, and both sides of all substitute forms.
- The marginal, perforated strips containing pin-fed holes must be removed from all forms prior to filing with the IRS.

3.4.2
Marginal Printing

Prior approval is not required for the marginal printing allowed when printed on an official form or on a photocopy of an official form.

- With the exception of the actual tax forms (for example, Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.), you may print in the left vertical margin and in the left half of the bottom margin.
- Printing is never allowed in the top right margin of the tax form (for example, Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.). The Service uses this area to imprint a Document Locator Number for each return. There are no exceptions to this requirement.

Section 3.5 – Examples of Approved Formats

3.5.1
Examples of Approved Formats From the Exhibits

Two sets of exhibits (Exhibits A-1 and 2; B-1 and 2) at the end of this revenue procedure are examples of how these guidelines may be used. Vertical spacing is six (6) lines to the inch. A combination of upper-case and lower-case print font is acceptable in producing substitute forms.

The same logic may be applied to any IRS form that is normally reproducible as a substitute form, with the exception of the tax return forms as discussed elsewhere.

Note. These exhibits may be from a prior year and are not to be used as current substitute forms.

Section 3.6 – Miscellaneous Information for Substitute Forms

3.6.1
Filing Substitute Forms

To be acceptable for filing, a substitute form must print out in a format that will allow the filer to follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package or in the related form instructions. The form must be legible, must be on the appropriately sized paper, and must include a jurat where one appears on the published form.

3.6.2
Caution to Software Publishers

The IRS has received returns produced by software packages with approved output where either the form heading was altered or the lines were spaced irregularly. This produces an illegible or unrecognizable return or a return with the wrong number of pages. We realize that many of these problems are caused by individual printer differences but they may delay input of return data and, in some cases, generate correspondence to the taxpayer. Therefore, in the instructions to the purchasers of your product, both individual and professional, please stress that their returns will be processed more efficiently if they are properly formatted. This includes:

- Having the correct form numbers and titles at the top of the return, and
- Submitting the same number of pages as if the form were an official IRS form with the line items on the proper pages.

3.6.3
Use Pre-Addressed IRS Label

If you are a practitioner filling out a return for a client or a software publisher who prints instruction manuals, stress the use of the pre-addressed label provided in the tax package the IRS sent to the taxpayer, when available. The use of this label (or its precisely duplicated label information) is extremely important for the efficient, accurate, and economical processing of a taxpayer's return. Labeled returns indicate that a taxpayer is an established filer and permits the IRS to automatically accelerate processing of those returns. This results in quicker refunds, less manual review by IRS functions, and greater accuracy in names, addresses, and postal deliveries.

3.6.4
Caution to Producers of Software Packages

If you are producing a software package that generates name and address data onto the tax return, do not under any circumstances program either the IRS preprinted check digits or a practitioner derived name control to appear on any return prepared and filed with the IRS.

3.6.5
Programming to Print Forms

Whenever applicable:

- Use only the following label information format for single filers:
  JOHN Q. PUBLIC
  310 OAK DRIVE
  HOMETOWN, STATE 94000
- Use only the following information for joint filers:
  JOHN Q. PUBLIC
  MARY I. PUBLIC
  310 OAK DRIVE
  HOMETOWN, STATE 94000

Part 4
Additional Resources

Section 4.1 – Guidance From Other Revenue Procedures

4.1.1
General

The IRS publications listed below provide guidance for substitute tax forms not covered in this revenue procedure. These publications are available on the IRS website. Identify the requested document by the IRS publication number.

- Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3.
- Publication 1179, General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S.
- Publication 1187, Specifications for Filing Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically.
- Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically.
- Publication 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c.
- Publication 1239, Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically or Magnetically.
- Publication 1345, Handbook for Authorized IRS *e-file* Providers of Individual Income Tax Returns.

- Publication 1345-A, Filing Season Supplement for Authorized IRS *e-file* Providers.
- Publication 4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941).

Section 4.2 – Electronic Tax Products

4.2.1
The IRS Website

Copies of tax forms with instructions, publications, draft forms, fillable forms, prior year forms and publications, and other tax-related information may be found on the IRS website at www.irs.gov.

4.2.2
Tax Products Posting Schedule

The IRS website provides a Tax Products Posting Schedule for the official forms released for use by taxpayers. The schedule has three parts.

- Anticipated print dates of annual returns.
- Anticipated print dates of quarterly returns.
- Last revision dates and target print dates for continuous-use forms.

The site address is www.irs.gov/formspubs/article/0,,id=103641,00.html. The site will be updated weekly during peak printing periods and as necessary at other times. The planned dates are subject to change.

Section 4.3 – Federal Tax Forms on CD

4.3.1
Information About Federal Tax Forms CD

The CD contains over 3,000 tax forms and publications for small businesses, return preparers, and others who frequently need current or prior year tax products. Most current tax forms on the CD may be filled in electronically, then printed out for submission and saved for recordkeeping. Other products on the CD include the Internal Revenue Bulletins, Tax Supplements, and Internet resources for the tax professional with links to the World Wide Web.

4.3.2
System Requirements and How To Order the Federal Tax Forms CD

For system requirements, contact the National Technical Information Service (NTIS) at http://www.ntis.gov. Prices are subject to change.

The cost of the CD if purchased via the Internet at http://www.irs.gov/cdorders from NTIS, is $35 (with no handling fee).

If purchased using the following methods, the cost for each CD is $35 (plus a $5 handling fee). These methods are:

- By phone – 1-877-CDFORMS (1-877-233-6767),
- By fax – 703-605-6900,
- By mail using the order form contained in IRS Publication 1045 (Tax Professionals Guide), and
- By mail to:
  National Technical Information Service
  5285 Port Royal Road
  Springfield, VA 22161

Part 5
Requirements for Specific Tax Returns

Section 5.1 – Tax Returns (Forms 1040, 1040A, 1120, etc.)

5.1.1
Acceptable Forms

Tax forms (such as Forms 1040, 1040A, and 1120) require a signature and establish tax liability. Computer generated versions are acceptable under the following conditions.

- These substitute forms must be printed on plain white paper.
- Substitute forms must conform to the physical layout of the corresponding IRS form although the typeface may differ. The text should match the text on the officially published form as closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis.
  Caution. All jurats (perjury statements) must be reproduced verbatim. No text can be added, deleted, or changed in meaning.
- Various computer graphic print media such as laser printing, inkjet printing, etc., may be used to produce the substitute forms.
- The substitute form must be the same number of pages and contain the same line text as the official form.
- All substitute forms must be submitted for approval prior to their original use. You do not need approval for a substitute form if its only change is the preprinted year and you had received a prior year approval letter.

  Exception. If the approval letter specifies a one time exception for your form, the next year's form must be approved.

5.1.2
Prohibited Forms

The following are prohibited.

- Computer generated tax forms (for example, Form 1040, etc.) on lined or color barred paper.
- Tax forms that differ from the official IRS forms in a manner that makes them non-standard or unable to process.

5.1.3
Changes Permitted to Forms 1040 and 1040A

Certain changes (listed in Sections 5.2 through 5.4) are permitted to the graphics of the form without prior approval, but these changes apply to only acceptable preprinted forms. Changes not requiring prior approval are good only for the annual filing period, which is the current tax year. Such changes are valid in subsequent years only if the official form does not change.

5.1.4
Other Changes Not Listed

All changes not listed in Sections 5.2 through 5.4 require approval from the IRS before the form can be filed.

Section 5.2 – Changes Permitted to Graphics (Forms 1040A and 1040)

5.2.1
Adjustments

You may make minor vertical and horizontal spacing adjustments to allow for computer or word processing printing. This includes widening the amount columns or tax entry areas if the adjustments comply with other provisions stated in revenue procedures. No prior approval is needed for these changes.

5.2.2
Name and Address Area

The horizontal rules and instructions within the name and address area may be removed and the entire area left blank. No line or instruction can remain in the area. However, the statement regarding use of the IRS label should be retained. The heavy ruled border (when present) that outlines the name, address area, and social security number must not be removed, relocated, expanded, or contracted.

5.2.3
Required Format

When the name and address area is left blank, the following format must be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled in as shown below.

- 1st name line (35 characters maximum).
- 2nd name line (35 characters maximum).
- In-care-of name line (35 characters maximum).
- City, state (25 characters maximum), one blank character, and ZIP code.

5.2.4
Conventional Name and Address Data

When there is no in-care-of name line, the name and address will consist of only three lines (single filer) or four lines (joint filer). Name and address (joint filer) with no in-care-of name line:

JOHN Z. JONES
MARY I. JONES
1234 ANYWHERE ST., APT. 111
ANYTOWN, STATE 12321

5.2.5
Example of In-Care-Of Name Line

Name and address (single filer) with in-care-of name line:

JOHN Z. JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, STATE 54345

5.2.6
SSN and Employer Identification Number (EIN) Area

The vertical lines separating the format arrangement of the SSN/EIN may be removed. When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-0000000, respectively.

5.2.7
Cents Column

- You may remove the vertical rule that separates the dollars from the cents.
- All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.

- You may omit printing the cents, but all amounts entered on the form must follow a consistent format. You are strongly urged to round off the figures to whole dollar amounts, following the official form instructions.
- When several amounts are summed together, the total should be rounded off after addition (that is, individual amounts should not be rounded off for computation purposes).
- When printing money amounts, you must use one of the following formats:
  (a) 0,000,000.;
  (b) 0,000,000.00.
- When there is no entry for a line, leave the line blank.

5.2.8 "Paid Preparer's Use Only" Area

On all forms, the paid preparer's information area may not be rearranged or relocated. You may add three lines and remove the horizontal rules in the preparer's address area.

Section 5.3 – Changes Permitted to Form 1040A Graphics

5.3.1 General

No prior approval is needed for the following changes (for use with computer prepared forms only).

5.3.2 Line 4 of Form 1040A

This line may be compressed horizontally (to allow for same line entry for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field).

5.3.3 Other Lines

Any line with text that takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

5.3.4 Page 2 of Form 1040A

All lines must be present and numbered in the order shown on the official form. These lines may also be compressed.

5.3.5 Color Screening

It is not necessary to duplicate the color screening used on the official form. A substitute Form 1040A may be printed in black and white only with no color screening.

5.3.6 Other Changes Prohibited

No other changes to the Form 1040A graphics are allowed without prior approval except for the removal of instructions and references to instructions.

Section 5.4 – Changes Permitted to Form 1040 Graphics

5.4.1
General

No prior approval is needed for the following changes (for use with computer prepared forms only). Specific line numbers in the following headings may have changed due to tax law changes.

5.4.2
Line 4 of Form 1040

This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field).

5.4.3
Line 6c of Form 1040

The vertical lines separating columns (1) through (4) may be removed. The captions may be shortened to allow a one line caption for each column.

5.4.4
Other Lines

Any other line with text that takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

5.4.5
Line 21 – Other Income

The fill-in portion of this line may be expanded vertically to three lines. The amount entry box must remain a single entry.

5.4.6
Line 44 of Form 1040 – Tax

You may change the line caption to read "Tax" and computer print the words "Total includes tax from" and either "Form(s) 8814," "Form 4972," or "Form(s) 8889." If all forms are used, print all form numbers. This specific line number may have changed.

5.4.7
Line 55 of Form 1040 – Other Credits

You may change the caption to read: "Other credits from Form" and computer print only the form(s) that apply.

5.4.8
Color Screening

It is not necessary to duplicate the color screening used on the official form. A substitute Form 1040 may be printed in black and white only with no color screening.

5.4.9
Other Changes Prohibited

No other changes to the Form 1040 graphics are permitted without prior approval except for the removal of instructions and references to instructions.

Part 6
Format and Content of Substitute Returns

Section 6.1 – Acceptable Formats for Substitute Forms and Schedules

6.1.1
Exhibits and Use of Acceptable Formats

Exhibits of acceptable formats for Schedule A, usually attached to the Form 1040, and Form 2106-EZ are shown in the exhibits section of this revenue procedure.

- If your computer generated forms appear exactly like the exhibits, no prior authorization is needed.
- You may computer generate forms not shown here, but you must design them by following the manner and style of those in the exhibits section.
- Take care to observe other requirements and conditions in this revenue procedure. The IRS encourages the submission of all proposed forms covered by this revenue procedure.

6.1.2
Instructions

The format of each substitute form or schedule must follow the format of the official form or schedule as to item captions, line references, line numbers, sequence, form arrangement and format, etc. Basically, try to make the form look like the official one, with readability and consistency being primary factors. You may use periods and/or other similar special characters to separate the various parts and sections of the form. Do not use alpha or numeric characters for these purposes. All line numbers and items must be printed even though an amount is not entered on the line.

6.1.3
Line Numbers

When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a substitute form. The reference code must be printed to the left of the text of each line and immediately preceding the data entry field, even if no reference code precedes the data entry field on the official form. If an entry field contains multiple lines and shows the line references once on the left and right side of the form, use the same number of line references on the substitute form.

In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first digit of the data field. (See example below.)

6.1.4
Decimal Points

A decimal point (that is, a period) should be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

5 STATE & LOCAL INC. TAXES...............	5.	495.00
6 REAL ESTATE TAXES............................	6.	
7 PERSONAL PROPERTY TAXES............	7.	198.00
or		
5 STATE & LOCAL INC. TAXES...............	(5)	495.00
6 REAL ESTATE TAXES.............................	(6)	
7 PERSONAL PROPERTY TAXES.............	(7)	198.00

6.1.5
Multi-Page Forms

When submitting a multi-page form, send all its pages in the same package.

Exception. If you will not be producing certain pages, please note that in your cover letter.

Section 6.2 – Additional Instructions for All Forms

6.2.1
Use of Your Own Internal Control Numbers and Identifying Symbols

You may show the computer prepared internal control numbers and identifying symbols on the substitute if using such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. Such information must not be printed in the top 1/2 inch clear area of any form or schedule requiring a signature. Except for the actual tax return form (Forms 1040, 1120, 940, 941, etc.), you may print in the left vertical and bottom left margins. The bottom left margin you may use extends 3 1/2 inches from the left edge of the form.

6.2.2
Descriptions for Captions, Lines, etc.

Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions, and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line, or item.

6.2.3
Determining Final Totals

Explanatory detail and/or intermediate calculations for determining final line totals may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the line on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved only for official numbered and lettered lines that correspond to the ones on the official form. Generally, you may choose the format for intermediate calculations or subtotals on supporting statements to be submitted.

6.2.4
Instructional Text on the Official Form

Text on the official form, which is solely instructional (for example, "See instructions," etc.), may generally be omitted from the substitute form.

6.2.5
Mixing Forms on the Same Page Prohibited

You may not show more than one form or schedule on the same printout page. Both sides of the paper may be printed for multi-page official forms, but it is unacceptable to intermix single page schedules of forms except for Schedules A and B (Form 1040), which are printed back to back by the IRS.

For instance, Schedule E can be printed on both sides of the paper because the official form is multi-page, with page 2 continued on the back. However, do not print Schedule E on the front page and Schedule SE on the back, or Schedule A on the front and Form 8615 on the back, etc. Both pages of a substitute form must match the official form. The back page may be left blank if the back page of the official form contains only the instructions.

6.2.6 Identifying Substitutes

Identify all computer prepared substitutes clearly. Print the form designation 1/2 inch from the top margin and 1 1/2 inches from the left margin. Print the title centered on the first line of print. Print the taxable year and, where applicable, the sequence number on the same line 1/2 inch to 1 inch from the right margin. Include the taxpayer's name and SSN on all forms and attachments. Also, print the OMB number as reflected on the official form.

6.2.7 Negative Amounts

Negative (or loss) amount entries should be enclosed in brackets or parentheses or include a minus sign. This assists in accurate computation and input of form data. The IRS pre-prints parentheses in negative data fields on many official forms. These parentheses should be retained or inserted on printouts of affected substitute forms.

Part 7
Miscellaneous Forms and Programs

Section 7.1 – Specifications for Substitute Schedules K-1

7.1.1 Requirements for Schedules K-1 That Accompany Forms 1041, 1065, 1065-B, and 1120S

Because of significant changes to improve processing, prior approval is now required for substitute Schedules K-1 that accompany Form 1041 (for estates and trusts), Form 1065 (for partnerships), Form 1065-B (for electing large partnerships), or Form 1120S (for S corporations). Substitute Schedules K-1 should be as close as possible to exact replicas of copies of the official IRS schedules and follow the same process for submitting other substitute forms and schedules. Before releasing their substitute forms, software vendors are responsible for making any subsequent changes that have been made to the final official IRS forms after the draft forms have been posted.

You must include all information on the form. Submit Schedules K-1 to the IRS at *Substituteforms@irs.gov* with "Attn: PDF Submissions" on the subject line or at:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP
1111 Constitution Avenue, NW
Room 6526
Washington, D.C. 20224

Include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120S.

- 661107 for Form 1041,
- 651107 for Form 1065, and
- 671107 for Form 1120S.

Please allow white space around the 6-digit code.

Schedules K-1 that accompany Forms 1041, 1065, 1065-B, or 1120S must meet all specifications. The specifications include, but are not limited to, the following requirements.

- You will no longer be able to produce Schedules K-1 that contain only those lines or boxes that taxpayers are required to use. All lines must be included.
- The words "*See attached statement for additional information." must be preprinted in the lower right hand side on Schedules K-1 of Forms 1041, 1065, and 1120S.
- All K-1s that are filed with the IRS should be printed on standard 8.5" x 11" paper (the international standard (A4) of 8.27" x 11.69" may be substituted).

- Each recipient's information must be on a separate sheet of paper. Therefore, you must separate all continuously printed substitutes, by recipient, before filing with the IRS.
- No carbon copies or pressure-sensitive copies will be accepted.
- The Schedule K-1 must contain the name, address, and SSN or EIN of both the entity (estate, trust, partnership, or S corporation) and the recipient (beneficiary, partner, or shareholder).
- The Schedule K-1 must contain the tax year, the OMB number, the schedule number (K-1), the related form number (1041, 1065, 1065-B, or 1120S), and the official schedule name in substantially the same position and format as shown on the official IRS schedule.
- The Schedule K-1 must contain all the line items as shown on the official form, except for the instructions, if any are printed on the back of the official Schedule K-1.
- The line items or boxes must be in the same order and arrangement as those on the official form.
- The amount of each recipient's share of each item must be shown. Furnishing a total amount of each item and a percentage (or decimal equivalent) to be applied to such total amount by the recipient does not satisfy the law and the specifications of this revenue procedure.
- State or local tax-related information may not be included on the Schedules K-1 filed with the IRS.
- The entity may have to pay a penalty if substitute Schedules K-1 are filed that do not conform to specifications.
- Additionally, the IRS may consider the Schedules K-1 that do not conform to specifications as not being able to be processed and may return Forms 1041, 1065, 1065-B, or 1120S to the filer to be filed correctly.

Schedules K-1 that are 2-D bar-coded will continue to require prior approval from the IRS (see Sections 7.1.3 through 7.1.5).

7.1.2
Special Requirements for Recipient Copies of Schedules K-1

Standardization for reporting information is required for recipient copies of substitute Schedules K-1 of Forms 1041, 1065, 1065-B, and 1120S. Uniform visual standards are provided to increase compliance by allowing recipients and practitioners to more easily recognize a substitute Schedule K-1. The entity must furnish to each recipient a copy of Schedule K-1 that meets the following requirements.

- Include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120S.
  - 661107 for Form 1041,
  - 651107 for Form 1065, and
  - 671107 for Form 1120S.

  Please allow white space around the 6-digit code.
- You will no longer be able to produce Schedules K-1 that contain only those lines or boxes that taxpayers are required to use. All lines must be included.
- Both pages 1 and 2 of Schedules K-1 of Forms 1065 and 1120S must be provided to each recipient.
- The words "*See attached statement for additional information." must be preprinted in the lower right hand side on Schedules K-1 of Forms 1041, 1065, and 1120S.
- The Schedule K-1 must contain the name, address, and SSN or EIN of both the entity and recipient.
- The Schedule K-1 must contain the tax year, the OMB number, the schedule number (K-1), the related form number (1041, 1065, 1065-B, or 1120S), and the official schedule name in substantially the same position and format as shown on the official IRS schedule.
- All applicable amounts and information required to be reported must be titled and numbered in the same manner as shown on the official IRS schedule. The line items or boxes must be in the same order and arrangement and must be numbered like those on the official IRS schedule.

- The Schedule K-1 must contain all items required for use by the recipient. The instructions to the schedule must identify the line or box number and code, if any, for each item as shown in the official IRS schedule.
- The amount of each recipient's share of each item must be shown. Furnishing a total amount of each line item and a percentage (or decimal equivalent) to be applied to such total amount by the recipient does not satisfy the law and the specifications of this revenue procedure.
- Instructions to the recipient that are substantially similar to those on or accompanying the official IRS schedule must be provided to aid in the proper reporting of the items on the recipient's income tax return. Where items are not reported to a recipient because they do not apply, the related instructions may be omitted.
- The quality of the ink or other material used to generate recipients' schedules must produce clearly legible documents. In general, black chemical transfer inks are preferred.
- In order to assure uniformity of substitute Schedules K-1, the paper size should be standard 8.5" x 11" (the international standard (A4) of 8.27" x 11.69" may be substituted.)
- The paper weight, paper color, font type, font size, font color, and page layout must be such that the average recipient can easily decipher the information on each page.
- State or local tax-related information may be included on recipient copies of substitute Schedules K-1. All non-tax-related information should be separated from the tax information on the substitute schedule to avoid confusion for the recipient.
- The legend "Important Tax Return Document Enclosed" must appear in a bold and conspicuous manner on the outside of the envelope that contains the substitute recipient copy of Schedule K-1.
- The entity may have to pay a penalty if a substitute Schedule K-1 furnished to any recipient does not conform to the specifications of this revenue procedure and results in impeding processing.

7.1.3 Requirements for Schedules K-1 with Two-Dimensional (2-D) Bar Codes

In an effort to reduce the burden of manually transcribing tax documents, improve quality, and increase government efficiency, the IRS is pleased to provide specifications for 2-D bar-coded substitute Schedules K-1 for Forms 1041, 1065, and 1120S. The IRS encourages voluntary participation in adding 2-D barcoding.

Note. If software vendors do not want to produce bar-coded Schedules K-1, they may produce the official IRS Schedules K-1 but cannot use the expedited process for approving bar-coded K-1s and their parent returns as outlined in Section 7.1.6.

In addition to the requirements in Sections 7.1.1 and 7.1.2, the bar-coded Schedules K-1 must meet the following specifications.

- The bar code should print in the space labeled "For IRS Use Only" on each Schedule K-1. The entire bar code must print within the "For IRS Use Only" box surrounded by a white space of at least 1/4 inch.
- Bar codes must print in PDF 417 format.
- The bar codes must always be in the specified format with every field represented by at least a field delimiter (carriage return). Leaving out a field in a bar code will cause every subsequent field to be misread.
- Be sure to include the 6-digit form ID code in the upper right of Schedules K-1 of Forms 1041, 1065, and 1120S.

  - 661107 for Form 1041,

  - 651107 for Form 1065, and

  - 671107 for Form 1120S.

  Please allow white space around the 6-digit code.

7.1.4 2-D Bar Code Specifications for Schedules K-1

Follow these general specifications for preparing all 2-D bar-coded Schedules K-1.

- Numeric fields –
  - Do not include leading zeros (except Taxpayer Identification Numbers, Zip Codes, and percentages).
  - Do not use non-numeric characters except that the literal "STMT" can be put in money fields.
  - All money fields should be rounded to the nearest whole dollar amount – If a money amount ends in 00 to 49 cents, drop the cents; if it ends in 50 to 99 cents, truncate the cents and increment the dollar amount by one. Use the same rounding technique for the bar-coded and the printed K-1s.
  - All numeric-only fields are right justified (except Taxpayer Identification Numbers and Zip Codes).
- All field lengths are expressed as maximum lengths. If the value in the field has fewer positions or the software program does not support that many positions, put in the bar code only those positions actually used.
- Alpha fields –
  - Do not include leading blanks (left justified).
  - Do not include trailing blanks.
  - Use uppercase alpha characters only.
- Variable fields –
  - Do not include leading blanks (left justified).
  - Do not include trailing blanks.
  - Use uppercase alpha characters, numerics, and special characters as defined in each field.
- Delimit each field with a carriage return.
- Express percentages as 6-digit numbers without the percent sign. Left justify with leading zeroes (for percentages less than 100%) and no decimal point (decimal point is assumed between 3rd and 4th positions). Examples: 25.32% expressed as "025320"; 105% expressed as "105000"; 8.275% expressed as "008275"; 10.24674% express as "010247".
- It is vital that the print routine reinitialize the bar code prior to printing each succeeding K-1. Failure to do this will result in each K-1 for a parent return having the same bar code as the document before it.

7.1.5 Approval Process for Bar-Coded Schedules K-1

Prior to releasing commercially available tax software that creates bar-coded Schedules K-1, the printed schedule and the bar code must both be tested. Bar code testing must be done using the final official IRS Schedule K-1. Bar code approval requests must be resubmitted for any subsequent changes to the official IRS form that would affect the bar code. Below are instructions and a sequence of events that will comprise the testing process.

- The IRS has released the final Schedule K-1 bar-code specifications by publishing them on the IRS.gov website (see *http://www.irs.gov/efile/article/0,,id=129859,00.html*).
- The IRS will publish a set of test documents that will be used to test the ability of tax preparation software to create bar codes in the correct format.

- Software developers will submit two identical copies of the test documents – one to the IRS and one to a contracted testing vendor.
- The IRS will use one set to ensure the printed schedules comply with standard substitute forms specifications.
- If the printed forms fail to meet the substitute form criteria, the IRS will inform the software developer of the reason for noncompliance.
- The software developer must resubmit the Schedule(s) K-1 until they pass the substitute forms criteria.
- The testing vendor will review the bar codes to ensure they meet the published bar-code specifications.
- If the bar code(s) does not meet published specifications, the testing vendor will contact the software developer directly informing them of the reason for noncompliance.
- Software developers must submit new bar-coded schedules until they pass the bar-code test.
- When the bar code passes, the testing vendor will inform the IRS that the developer has passed the bar-code test and the IRS will issue an overall approval for both the substitute form and the bar code.
- After receiving this consolidated response, the software vendor is free to release software for tax preparation as long as any subsequent revisions to the schedules do not change the fields.
- Find the mailing address for the testing vendor below. Separate and simultaneous mailings to the IRS and the vendor will reduce testing time.

7.1.6 Procedures for Reducing Testing Time

In order to help provide incentives to the software development community to participate in the Schedule K-1 2-D project, the IRS has committed to expediting the testing of bar-coded Schedules K-1 and their associated parent returns. To receive this expedited service, follow the instructions below.

- Mail the parent returns (Forms 1065, 1120S, 1041) and associated bar-coded Schedule(s) K-1 to the appropriate address below in a separate package from all other approval requests.

  Internal Revenue Service
  Attn: Bar-Coded K-1
  SE:W:CAR:MP:T:T:SP
  1111 Constitution Avenue, NW
  Room 6526
  Washington, D.C. 20224

- Mail one copy of the parent form(s) and Schedule(s) K-1 to the IRS and another copy to the testing vendor at the address below.

  Northrop Grumman Information Tech
  Attn: Betty Ragonese, Quality Assurance Lead
  1800 Alexander Bell Drive
  Suite 300
  Reston, VA 20191
  Phone: 703-453-1200

- Include multiple email and phone contact points in the packages.
- While the IRS can expedite bar-coded Schedules K-1 and their associated parent returns, it cannot expedite the approval of non-associated tax returns.

Section 7.2 – Procedures for Printing IRS Envelopes

7.2.1 Procedures for Printing IRS Envelopes

Organizations are permitted to produce substitute tax return envelopes. Use of substitute return envelopes that comply with the requirements set forth in this section will assist in delivery of mail by the U.S. Postal Service and facilitate internal sorting at the Internal Revenue Service Centers.

Use the following 5-digit ZIP codes when mailing returns to the IRS Service Centers:

Service Center	ZIP Code
Atlanta, GA	39901
Kansas City, MO	64999
Austin, TX	73301
Philadelphia, PA	19255
Memphis, TN	37501
Andover, MA	05501
Cincinnati, OH	45999
Ogden, UT	84201
Fresno, CA	93888

7.2.2 Sorting Returns by Form Type

Sorting returns by form type is accomplished by the preprinted bar codes on return envelopes included in each specific type of form or package mailed to the taxpayers. The 32-bit bar code on the left of the address on each envelope identifies the type of form the taxpayer is filing, and it assists in consolidating like returns for processing. Failure to use the envelopes furnished by the IRS results in additional processing time and effort, and possibly delays the timely deposit of funds, processing of returns, and issuance of refund checks.

7.2.3 ZIP+4 or 9-Digit ZIP Codes

The IRS will not furnish or sell bulk quantities of preprinted tax return envelopes to taxpayers or tax practitioners. A suitable alternative has been developed that will accommodate the sorting needs of both the IRS and the United States Postal Service (USPS). The alternative is based on the use of ZIP+4, or 9-digit ZIP codes, for mailing various types of tax returns to the IRS Service Centers. The IRS uses the last four digits to identify and sort the various form types into separate groups for processing. The list of 4-digit extensions with the related form designations is provided below.

ZIP+4	Package
XXXXX-0002	1040
XXXXX-0005	941
XXXXX-0006	940
XXXXX-0008	943

ZIP+4	Package
XXXXX-0011	1065
XXXXX-0012	1120
XXXXX-0013	1120S
XXXXX-0014	1040EZ
XXXXX-0015	1040A
XXXXX-0027	990
XXXXX-0031	2290

7.2.4
Guidelines for Having Envelopes Preprinted

You may use the preparers' company names, addresses, and logos as long as you do not interfere with the clear areas. The government recommends that the envelope stocks have an average opacity of not less than 89 percent and contain a minimum of 50 percent waste paper. Use of carbon based ink is essential for effective address and bar-code reading. Envelope construction can be of side seam or diagonal seam design. The government recommends that the size of the envelope should be 5¾ inches by 9 inches. Continuous pin-fed construction is not desirable, but is permissible, if the glued edge is at the top. This requirement is firm because mail opening equipment is designed to open the bottom edge of each envelope.

7.2.5
Envelopes/ZIP Codes

The above procedures or guidelines are written for the user having envelopes preprinted. Many practitioners may not wish to have large quantities of envelopes with differing ZIP codes/form designations preprinted due to low volume, warehousing, waste, etc. In this case, the practitioner can type or machine print the addresses with the appropriate ZIP codes to accommodate sorting. If the requirements/guidelines outlined in this section cannot be met, then use only the appropriate 5-digit service center ZIP code.

Section 7.3 – Guidelines for Substitute Forms 8655

7.3.1
Increased Standardization for Forms 8655

Increased standardization for reporting information on substitute Forms 8655 is now required to aid in processing and for compliance purposes. Please follow the guidelines in Section 7.3.2.

7.3.2
Requirements for Substitute Forms 8655

Please follow these specific requirements when producing substitute Forms 8655.

- The first line of the title must be "Reporting Agent Authorization."
- If you want to include a reference to "State Limited Power of Attorney," it can be in parentheses under the title. "State" must be the first word within the parentheses.
- You must include "Form 8655" on the form.
- While the line numbers do not have to match the official form, the sequence of the information must be in the same order.
- The size of any variable data must be printed in a font no smaller than 10-point.

- For adequate disclosure checks, the following must be included for each taxpayer:
  (a) Name,
  (b) EIN, and
  (c) Address.

- At this time, Form 944 will not be required if Form 941 is checked. Only those forms that the reporting agent company supports need to be listed.
- The jurat (perjury statement) must be identical with the exception of references to line numbers.
- A contact name and number for the reporting agent is not required.
- You must include line 17, or the equivalent line, and it must include two checkboxes.
- Any state information included should be contained in a separate section of the substitute form. Preferably this information will be in the same area as line 19 of the official form.
- All substitute Forms 8655 must be approved by the Substitute Forms Unit as outlined in the Form 8655 specifications in Publication 1167.
- If you have not already been assigned a 3-letter source code, you will be given one when your substitute form is submitted for approval. This source code should be included in the lower left corner of the form.
- The 20-day assumed approval policy does not apply to Form 8655 approvals.

Part 8
Alternative Methods of Filing

Section 8.1 – Forms for Electronically Filed Returns

8.1.1
Electronic Filing Program

Electronic filing is a method by which authorized providers transmit tax return information to an IRS Service Center in the format of the official IRS forms. The IRS accepts both refund and balance due Form 1040, 1040A, 1040EZ, or 1040SS (PR) tax returns that are filed electronically.

8.1.2
Applying to Participate in IRS *e-file*

Anyone wishing to participate in IRS *e-file* of tax returns must submit an *e-file* application. The application can be completed and submitted electronically on the IRS website at www.irs.gov after first registering for e-services on the website.

8.1.3
Obtaining the Taxpayer Signature / Submission of Required Paper Documents

Beginning with the 2008 filing season, tax practitioners can e-file individual income tax returns only if the returns are signed electronically using a Personal Identification Number (PIN). A newly designed Form 8453, U.S. Individual Income Tax Transmittal for an IRS *e-file* Return, will serve as a transmittal for association of required paper documents such as Forms 3115, 5713, 8283, and 8332. Form 8453 is a one-page form and can only be approved through the Substitute Forms Program in that format.

Form 8453-OL, U.S. Individual Income Tax Declaration for an IRS *e-file* Online Return, is the paper signature document for an electronically filed individual tax return not filed with an electronic PIN signature. The Form 8453-OL also serves as a transmittal for association of required paper documents for taxpayers filing through an online provider.

For specific information about electronic filing, refer to Publication 1345, Handbook for Authorized IRS *e-file* Providers of Individual Income Tax Returns.

8.1.4
Guidelines for Preparing Substitute Forms in the Electronic Filing Program

A participant in the electronic filing program, who wants to develop a substitute form should follow the guidelines throughout this publication and send a sample form for approval to the Substitute Forms Unit at the address in Part 1. If you do not prepare Substitute Form 8453 using a font in which all IRS wording fits on a single page, the form will not be accepted.

Note. Use of unapproved forms could result in suspension of the participant from the electronic filing program.

Section 8.2 – Effect on Other Documents

8.2.1
Effect on Other Documents

This revenue procedure supersedes Revenue Procedure 2007-24, 2007-11 I.R.B. 692.

Exhibit A-1 (Preferred Format)

SCHEDULES A&B (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Schedule A—Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedules A&B (Form 1040).

OMB No. 1545-0074

2007

Attachment Sequence No. **07**

Name(s) shown on Form 1040 | Your social security number

Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see page A-1)	1	
	2	Enter amount from Form 1040, line 38 [2]		
	3	Multiply line 2 by 7.5% (.075)	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4
Taxes You Paid (See page A-2.)	5	State and local **(check only one box):** a ☐ Income taxes, **or** b ☐ General sales taxes	5	
	6	Real estate taxes (see page A-5)	6	
	7	Personal property taxes	7	
	8	Other taxes. List type and amount ▶	8	
	9	Add lines 5 through 8		9
Interest You Paid (See page A-5.)	10	Home mortgage interest and points reported to you on Form 1098	10	
Note. Personal interest is not deductible.	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-6 and show that person's name, identifying no., and address ▶	11	
	12	Points not reported to you on Form 1098. See page A-6 for special rules	12	
	13	Qualified mortgage insurance premiums (See page A-7)	13	
	14	Investment interest. Attach Form 4952 if required. (See page A-7.)	14	
	15	Add lines 10 through 14		15
Gifts to Charity If you made a gift and got a benefit for it, see page A-8.	16	Gifts by cash or check. If you made any gift of $250 or more, see page A-8	16	
	17	Other than by cash or check. If any gift of $250 or more, see page A-8. You **must** attach Form 8283 if over $500	17	
	18	Carryover from prior year	18	
	19	Add lines 16 through 18		19
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See page A-9.)		20
Job Expenses and Certain Miscellaneous Deductions (See page A-9.)	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-9.) ▶	21	
	22	Tax preparation fees	22	
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23	
	24	Add lines 21 through 23	24	
	25	Enter amount from Form 1040, line 38 [25]		
	26	Multiply line 25 by 2% (.02)	26	
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-		27
Other Miscellaneous Deductions	28	Other—from list on page A-10. List type and amount ▶		28
Total Itemized Deductions	29	Is Form 1040, line 38, over $156,400 (over $78,200 if married filing separately)? ☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. ☐ **Yes.** Your deduction may be limited. See page A-10 for the amount to enter. ▶		29
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐		

For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule A (Form 1040) 2007

Exhibit A-2 (Acceptable Format)

SCHEDULES A&B (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Schedule A—Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedules A&B (Form 1040).

OMB No. 1545-0074

2007

Attachment Sequence No. 07

Name(s) shown on Form 1040 | **Your social security number**

Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see page A-1)	1	
	2	Enter amount from Form 1040, line 38 [2]		
	3	Multiply line 2 by 7.5% (.075)	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4
Taxes You Paid (See page A-2.)	5	State and local **(check only one box):** a ☐ Income taxes, or b ☐ General sales taxes	5	
	6	Real estate taxes (see page A-5)	6	
	7	Personal property taxes	7	
	8	Other taxes. List type and amount ▶	8	
	9	Add lines 5 through 8		9
Interest You Paid (See page A-5.)	10	Home mortgage interest and points reported to you on Form 1098	10	
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-6 and show that person's name, identifying no., and address ▶	11	
Note. Personal interest is not deductible.	12	Points not reported to you on Form 1098. See page A-6 for special rules	12	
	13	Qualified mortgage insurance premiums (See page A-7)	13	
	14	Investment interest. Attach Form 4952 if required. (See page A-7.)	14	
	15	Add lines 10 through 14		15
Gifts to Charity If you made a gift and got a benefit for it, see page A-8.	16	Gifts by cash or check. If you made any gift of $250 or more, see page A-8	16	
	17	Other than by cash or check. If any gift of $250 or more, see page A-8. You **must** attach Form 8283 if over $500	17	
	18	Carryover from prior year	18	
	19	Add lines 16 through 18		19
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See page A-9.)		20
Job Expenses and Certain Miscellaneous Deductions (See page A-9.)	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-9.) ▶	21	
	22	Tax preparation fees	22	
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23	
	24	Add lines 21 through 23	24	
	25	Enter amount from Form 1040, line 38 [25]		
	26	Multiply line 25 by 2% (.02)	26	
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-		27
Other Miscellaneous Deductions	28	Other—from list on page A-10. List type and amount ▶		28
Total Itemized Deductions	29	Is Form 1040, line 38, over $156,400 (over $78,200 if married filing separately)? ☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. ☐ **Yes.** Your deduction may be limited. See page A-10 for the amount to enter. ▶		29
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐		

For Paperwork Reduction Act Notice, see Form 1040 instructions. **Schedule A (Form 1040) 2007**

Exhibit B-1 (Preferred Format)

Form **2106-EZ**

Department of the Treasury
Internal Revenue Service (99)

Unreimbursed Employee Business Expenses

▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

2007

Attachment Sequence No. **54A**

Your name	Occupation in which you incurred expenses	Social security number

You May Use This Form Only if All of the Following Apply.

- You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.
- You **do not** get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements for this purpose).
- If you are claiming vehicle expense, you are using the standard mileage rate for 2007.

Caution: *You can use the standard mileage rate for 2007* ***only if: (a)*** *you owned the vehicle and used the standard mileage rate for the first year you placed the vehicle in service,* ***or (b)*** *you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.*

Part I **Figure Your Expenses**

1	Vehicle expense using the standard mileage rate. Complete Part II and multiply line 8a by 48.5¢ (.485)	1	
2	Parking fees, tolls, and transportation, including train, bus, etc., that **did not** involve overnight travel or commuting to and from work	2	
3	Travel expense while away from home overnight, including lodging, airplane, car rental, etc. **Do not** include meals and entertainment	3	
4	Business expenses not included on lines 1 through 3. **Do not** include meals and entertainment	4	
5	Meals and entertainment expenses: $ ________ × 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 75% (.75) instead of 50%. For details, see instructions.)	5	
6	**Total expenses.** Add lines 1 through 5. Enter here and on **Schedule A (Form 1040), line 21** (or on **Schedule A (Form 1040NR, line 9)**). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	

Part II **Information on Your Vehicle.** Complete this part **only** if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) ▶ .... / .... / ....

8 Of the total number of miles you drove your vehicle during 2007, enter the number of miles you used your vehicle for:

a Business .... b Commuting (see instructions) .... c Other ....

9 Do you (or your spouse) have another vehicle available for personal use? ☐ Yes ☐ No

10 Was your vehicle available for personal use during off-duty hours? ☐ Yes ☐ No

11a Do you have evidence to support your deduction? ☐ Yes ☐ No

b If "Yes," is the evidence written? ☐ Yes ☐ No

For Paperwork Reduction Act Notice, see page 4. Form **2106-EZ** (2007)

Exhibit B-2 (Acceptable Format)

Form **2106-EZ**

Department of the Treasury
Internal Revenue Service (99)

Unreimbursed Employee Business Expenses

▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

2007

Attachment Sequence No. **54A**

Your name	Occupation in which you incurred expenses	Social security number

You May Use This Form Only if All of the Following Apply.

- You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.
- You **do not** get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements for this purpose).
- If you are claiming vehicle expense, you are using the standard mileage rate for 2007.

Caution: *You can use the standard mileage rate for 2007* ***only if: (a)*** *you owned the vehicle and used the standard mileage rate for the first year you placed the vehicle in service,* ***or (b)*** *you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.*

Part I Figure Your Expenses

1	Vehicle expense using the standard mileage rate. Complete Part II and multiply line 8a by 48.5¢ (.485)	1	
2	Parking fees, tolls, and transportation, including train, bus, etc., that **did not** involve overnight travel or commuting to and from work	2	
3	Travel expense while away from home overnight, including lodging, airplane, car rental, etc. **Do not** include meals and entertainment	3	
4	Business expenses not included on lines 1 through 3. **Do not** include meals and entertainment	4	
5	Meals and entertainment expenses: $ ________ × 50% (.50). (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 75% (.75) instead of 50%. For details, see instructions.)	5	
6	**Total expenses.** Add lines 1 through 5. Enter here and on **Schedule A (Form 1040), line 21** (or on **Schedule A (Form 1040NR, line 9)**). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	

Part II **Information on Your Vehicle.** Complete this part **only** if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) ▶ .... / .... / ....

8 Of the total number of miles you drove your vehicle during 2007, enter the number of miles you used your vehicle for:

a Business .... **b** Commuting (see instructions) .... **c** Other ....

9 Do you (or your spouse) have another vehicle available for personal use? ☐ **Yes** ☐ **No**

10 Was your vehicle available for personal use during off-duty hours? ☐ **Yes** ☐ **No**

11a Do you have evidence to support your deduction? ☐ **Yes** ☐ **No**

b If "Yes," is the evidence written? ☐ **Yes** ☐ **No**

For Paperwork Reduction Act Notice, see page 4. Form **2106-EZ** (2007)

Exhibit C
Software Developers Voucher

Form **1040-ES**

Department of the Treasury
Internal Revenue Service

Estimated Tax for Individuals

OMB No. 1545-0074

2007

Tear off here

Form **1040-ES** Department of the Treasury Internal Revenue Service | **2007** Payment Voucher **4** | OMB No. 1545-0074

File only if you are making a payment of estimated tax by check or money order. Mail this voucher with your check or money order payable to the **"United States Treasury."** Write your social security number and "2007 Form 1040-ES" on your check or money order. Do not send cash. Enclose, but do not staple or attach, your payment with this voucher.

Calendar year—Jan. 15, 2008		
Amount of estimated tax you are paying by check or money order.	Dollars	Cents
	1,425	

XXXX

William T THOMAS
511 JONATHAN CAROL BLVD
JEWELL, OH 43530

PO BOX 970006
ST. LOUIS, MO 63197-0006

400011018 HT THOM 30 0 200712 430

Exhibit D

Check Sheet of IRS Substitute Forms 20 :
Submitted on

Company: . . . .
Contact: . . . .
Phone: . . . .
Fax: . . . .
Source Code: . . . .

Form Number	Approved	Approved With Corrections	Comments

Authorized Name: ______________________________
Title: ______________________________
Reviewer's Name: ______________________________
Telephone: ______________________________
Date: ______________________________

Section 45H. —Credit for Production of Low Sulfur Diesel Fuel

Rev. Proc. 2007–69

SECTION 1. PURPOSE

This revenue procedure provides the procedure under which small business refiners may obtain from the Internal Revenue Service a certification that satisfies the requirements of § 45H(f)(1) of the Internal Revenue Code, relating to certifications that costs with respect to a facility will result in compliance with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency (EPA).

SECTION 2. BACKGROUND AND DEFINITIONS

.01 Section 45H, which was added to the Code by § 339(a) of the American Jobs Creation Act of 2004 (Public Law No. 108–357), provides a low sulfur diesel fuel production credit for low sulfur diesel fuel produced by a small business refiner. Section 45H(a) provides that the amount of the credit is 5 cents per gallon of low sulfur diesel fuel produced by a small business refiner.

.02 Section 45H(b)(1) provides that the aggregate credit determined under § 45H(a) for any taxable year with respect to any facility shall not exceed—

(1) 25 percent of the qualified capital costs incurred by the small business refiner with respect to the facility, reduced by

(2) The aggregate credits determined under § 45H for all prior taxable years with respect to the facility.

.03 Under § 45H(b)(2), in the case of a small business refiner with average daily domestic refinery runs for the 1-year period ending on December 31, 2002, in excess of 155,000 barrels, the number of percentage points described in § 45H(b)(1) (25 percentage points) shall be reduced (not below zero) by the product of such number (before the application of § 45H(b)(2)) and the ratio of the excess to 50,000 barrels.

.04 Section 45H(c)(1) defines the term "small business refiner" to mean, with respect to any taxable year, a refiner of crude oil that meets the following requirements:

(1) Not more than 1,500 individuals are engaged in the refinery operations of the business on any day during the taxable year; and

(2) The average daily domestic refinery run or average retained production for all facilities of the taxpayer for the 1-year period ending on December 31, 2002, did not exceed 205,000 barrels.

.05 Section 45H(c)(2) defines the term "qualified capital costs." The qualified capital costs with respect to any facility are those costs that are paid or incurred during the applicable period for compliance with the applicable EPA regulations with respect to the facility, including expenditures for the construction of new process operations units or the dismantling and reconstruction of existing process units to be used in the production of low sulfur diesel fuel, associated adjacent or offsite equipment (including tankage, catalyst, and power supply), engineering, construction period interest, and sitework.

.06 Section 45H(c)(3) defines the term "applicable EPA regulations" as the Highway Diesel Fuel Sulfur Control Requirements of the EPA (applicable EPA regulations). Heavy-duty highway vehicles for the 2007 and later model years must be fueled with highway diesel fuel that meets a maximum sulfur standard of 15 parts per million (ppm). The applicable EPA regulations generally require petroleum refiners that produce diesel fuel for heavy-duty highway vehicles to produce this low sulfur diesel fuel beginning June 1, 2006. However, the applicable EPA regulations provide additional time to comply with the 15 ppm sulfur standard under certain circumstances.

.07 Section 45H(c)(4) defines the term "applicable period." The applicable period with respect to any facility is the period beginning on January 1, 2003, and ending on the earlier of the date that is one year after the date on which the taxpayer must comply with the applicable EPA regulations with respect to that facility, or December 31, 2009.

.08 Section 45H(c)(5) defines the term "low sulfur diesel fuel" as diesel fuel with a sulfur content of 15 ppm or less.

.09 Section 45H(f)(1) provides that no credit for the production of low sulfur diesel fuel under § 45H shall be allowed unless, not later than the date that is 30 months after the first day of the first taxable year in which the low sulfur diesel fuel production credit is determined with respect to a facility, the small business refiner obtains certification from the Secretary, after consultation with the Administrator of the EPA, that the taxpayer's qualified costs with respect to the facility will result in compliance with the applicable EPA regulations.

.10 Section 45H(f)(2) provides that an application for certification shall include relevant information regarding unit capacities and operating characteristics sufficient for the Secretary, after consultation with the Administrator of the EPA, to determine that the qualified capital costs are necessary for compliance with the applicable EPA regulations.

.11 Under § 45H(f)(3), any application shall be reviewed and notice of certification, if applicable, shall be made within 60 days of receipt of the application. In the event the Secretary does not notify the taxpayer of the results of the certification within this time period, the taxpayer may presume the certification to be issued until so notified.

.12 Section 45H(f)(4) provides that, with respect to the credit allowed under § 45H—

(1) The statutory period for assessment of any deficiency attributable to the credit shall not expire before the end of the 3-year period ending on the date that the review period described in § 45H(f)(3) ends with respect to the taxpayer; and

(2) The deficiency may be assessed before the expiration of the 3-year period notwithstanding the provisions of any other law or rule of law that would otherwise prevent the assessment.

.13 Section 45H is effective for expenses paid or incurred after December 31, 2002, in taxable years ending after that date.

SECTION 3. SCOPE

This revenue procedure applies to small business refiners that pay or incur qualified capital costs after December 31, 2002, in taxable years ending after that date.

SECTION 4. PROCEDURE FOR OBTAINING CERTIFICATION

.01 The certification required under § 45H(f)(1) (relating to certifications by the Secretary that the taxpayer's qualified costs with respect to the facility will result in compliance with the applicable EPA regulations) is issued by the Internal Revenue Service after consultation with the EPA. A taxpayer seeking to obtain such a certification must submit one paper copy and one electronic version on a floppy disc or CD of the application for certification under section 45H(f) to the Internal Revenue Service and one paper copy and one electronic version of the application to the EPA. Applications for certification under section 45H(f) should be marked: SECTION 45H(f) APPLICATION FOR CERTIFICATION. There is no user fee for these applications. The application for a certification with respect to a facility must contain the following information:

(1) The taxpayer's name, address, and taxpayer identification number;

(2) A description of the facility;

(3) The unit capacities and operating characteristics of the facility;

(4) Whether the facility is currently producing low sulfur diesel fuel; and

(5) A description of the qualified capital costs with respect to the facility.

.02 The electronic version of the application MUST be formatted in one of the following software applications:

Microsoft Word™ 2002 or later edition

Microsoft Excel™ 2002 or later edition

Adobe Acrobat™ PDF 6.0 or later edition

Information submitted using the Excel™ spreadsheet must include calculation formulas and assumptions.

.03 A separate application is required for each facility for which qualified capital costs are paid or incurred.

.04 The following declaration must accompany an application: "Under penalties of perjury, I declare that I have examined this application, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete." The declaration must be signed by a person authorized to submit the application on behalf of the taxpayer.

.05 The applications should be sent to the following addresses:

(1) Applications to the Internal Revenue Service:

(a) Applications submitted by U.S. mail must be sent to:

Internal Revenue Service
Industry Director, Natural Resources and Construction
Attn: Executive Assistant
1919 Smith Street
Stop HOU 1000
Houston, TX 77002

(b) Applications submitted by a private delivery service must be sent to:

Internal Revenue Service
Industry Director, Natural Resources and Construction
Attn: Executive Assistant
1919 Smith Street, Floor P2
Stop HOU 1000
Houston, TX 77002

(c) Applications may also be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. Central time to:

Internal Revenue Service
Industry Director, Natural Resources and Construction
Attn: Executive Assistant
1919 Smith Street, Floor P2
Stop HOU 1000
Houston, TX 77002

(2) Applications to the Environmental Protection Agency:

(a) Applications submitted by U.S. mail must be sent to:

Environmental Protection Agency
Director, Compliance and Innovative Strategies Division
1200 Pennsylvania Ave, NW (6403J)
Washington, DC 20460

(b) Applications submitted by a private delivery service must be sent to:

Environmental Protection Agency
Director, Compliance and Innovative Strategies Division
1310 L Street, NW — 6th Floor Mail Code 6403J
Washington, DC 20005

(c) Applications may also be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. Eastern time to:

Environmental Protection Agency
Director, Compliance and Innovative Strategies Division
1310 L Street, NW — 6th Floor Mail Code 6403J
Washington, DC 20005

.06 The 60-day review period under § 45H(f)(3) does not begin until the Service receives a complete application. An application will not be considered complete if the Service, after the consultation with the EPA, determines that the application does not contain all of the information necessary to determine whether the taxpayer's costs with respect to the facility result in compliance with the applicable EPA regulations. If the Service does not notify the taxpayer that the application is incomplete within 60 days of receipt of the taxpayer's application, a taxpayer may presume the application to be complete.

.07 The certification will ordinarily be granted with respect to a facility if the application is complete, nothing in the application is inconsistent with a finding that the taxpayer's qualified capital costs with respect to the facility will result in compliance with the applicable EPA regulations, and the taxpayer has not been subject to a penalty under the applicable EPA regulations for a violation relating to that facility. If the taxpayer has been subject to a penalty under the applicable EPA regulations for a violation relating to the facility, the Service, after consultation with the EPA, will take all relevant information into account in determining whether certification will be granted or denied.

.08 The Service will notify the taxpayer whether certification has been granted or denied. If the Service does not notify the taxpayer whether certification has been granted or denied within 60 days of receipt of the taxpayer's complete application (or within 60 days of receipt of an application that is presumed to be complete under section 4.06), the taxpayer may presume that the certification has been granted during the period that begins 60 days after the receipt of the complete (or presumptively complete) application and ends on the date the taxpayer is notified that the applica-

tion is denied or incomplete. If the taxpayer is permitted under this section 4.08 to presume for any period that the certification with respect to a facility has been granted—

(1) The taxpayer will be treated as satisfying the certification requirement of section 45H(f)(1) in determining whether the credit under section 45H is allowable with respect to fuel produced at the facility during that period; and

(2) The running of the 30-month period applicable to the facility under section 45H(f)(1) will be suspended for the period during which the taxpayer is permitted to presume the certification with respect to the facility has been granted.

.09 All inquiries regarding the status of a certification request should be sent to the Service at the address listed in section 4.05(1) (or the taxpayer may call (713) 209–3615 (not a toll-free call)).

SECTION 5. EFFECT OF CERTIFICATION

.01 Granting the certification establishes only that the taxpayer has satisfied the requirement of section 45H(f) and does not preclude the Service from examining a taxpayer's return with respect to the low sulfur diesel fuel production credit. The certification does not establish that the taxpayer is a small business refiner, that fuel produced by the taxpayer is low sulfur diesel fuel, or that any expenditure is a qualified capital cost. Thus, the certification is not a determination by the Service that the costs the taxpayer identifies as qualified capital costs on the application for certification are, in fact, qualified capital costs.

.02 Only one certification is required with respect to a facility. Thus, a taxpayer that incurs additional qualified capital costs with respect to a facility after obtaining a certification with respect to the facility is not required to obtain a new certification with respect to that facility.

SECTION 6. EFFECTIVE DATE AND TRANSITION RULE

.01 This revenue procedure is effective for applications filed after November 9, 2007.

.02 Any certification issued before June 30, 2008, will be treated as issued before the end of the 30-month period described in section 45H(f)(1).

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–2074.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 4. This information will be used to determine if the qualified capital costs of a small business refiner are necessary for compliance with the applicable EPA regulations. This information collection is voluntary.

The likely respondents are small business refiners within the meaning of § 45H(c)(1). The estimated total annual reporting burden is 75 hours. The estimated annual burden per respondent varies from 1 hour to 2 hours, depending on individual circumstances, with an estimated average of 1.5 hours. The estimated total number of respondents is 50. The estimated frequency of responses is once per respondent.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is David Selig of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Nicole Cimino at (202) 622–3110 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Automatic Contribution Arrangements

REG–133300–07

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of Proposed Rulemaking

SUMMARY: This document contains proposed regulations under sections 401(k), 401(m), 402(c), 411(a), 414(w), and 4979(f) of the Internal Revenue Code relating to automatic contribution arrangements. These proposed regulations will affect administrators of, employers maintaining, participants in, and beneficiaries of eligible plans that include an automatic contribution arrangement under section 401(k)(13), 401(m)(12), or 414(w).

DATES: Written or electronic comments and requests for a public hearing must be received by February 6, 2008.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–133300–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington D.C. 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–133300–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, or sent electronically via the Federal erulemaking Portal at *www.regulations.gov* (IRS REG–133300–07).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad, Dana Barry or William D. Gibbs at (202) 622–6060; concerning the submission of comments or to request a public hearing, *Richard.A.Hurst@irscounsel.treas.gov*, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by January 7, 2008. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in these proposed regulations is in §§1.401(k)–3 and 1.414(w)–1. The collection of information in §1.401(k)–3 is required to comply with the statutory notice requirements of sections 401(k)(13) and 401(m)(12), and is expected to be included in the notices currently provided to employees that inform them of their rights and benefits under the plan. The collection of information under §1.414(w)–1 is required to comply with the statutory notice requirements of section 414(w), and is expected to be included in the notices currently provided to employees that inform them of their rights and benefits under the plan. The likely recordkeepers are businesses or other for-profit institutions, nonprofit institutions, organizations, and state or local governments.

Estimated total average annual recordkeeping burden: 30,000 hours.

Estimated average annual burden hours per recordkeeper: 1 hour.

Estimated number of recordkeepers: 30,000.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to regulations under sections 401(k), 401(m), 402(c), 411(a), and 4979 of the Internal Revenue Code (Code) and new proposed regulations under section 414(w) in order to reflect the provisions of section 902 of the Pension Protection Act of 2006, Public Law 109–280 (PPA '06). Section 902 of PPA '06 added sections 401(k)(13), 401(m)(12), and 414(w) to the Code to facilitate automatic contribution arrangements (sometimes referred to as automatic enrollment) in qualified cash or deferred arrangements under section 401(k), as well as in similar arrangements under sections 403(b) and 457(b). An automatic contribution arrangement is a cash or deferred arrangement that provides that, in the absence of an affirmative election by an eligible employee, a default election applies under which the employee is

treated as having made an election to have a specified contribution made on his or her behalf under the plan. These regulations would also amend the comprehensive regulations under sections 401(k) and 401(m) (published in 2004) and regulations under section 4979 to reflect other changes made by section 902 of PPA '06.

Section 401(k)(1) provides that a profit-sharing, stock bonus, pre-ERISA money purchase or rural cooperative plan will not fail to qualify under section 401(a) merely because it contains a qualified cash or deferred arrangement. Section 1.401(k)–1(a)(2) defines a cash or deferred arrangement (CODA) as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a). Section 1.401(k)–1(a)(3) defines a cash or deferred election as any direct or indirect election (or modification of an earlier election) by an employee to have the employer either: (1) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available; or (2) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. For purposes of determining whether an election is a cash or deferred election, §1.401(k)–1(a)(3) provides that it is irrelevant whether the default that applies in the absence of an affirmative election is cash (or some other taxable benefit) or a contribution, an accrual, or other benefit under a plan deferring the receipt of compensation. Contributions that are made pursuant to a cash or deferred election under a qualified CODA are commonly referred to as elective contributions.

In order for a CODA to be a qualified CODA, it must satisfy a number of other requirements. First, pursuant to section 401(k)(2)(A), the amount that each eligible employee under the arrangement may defer as an elective contribution must be available to the employee in cash. Section 1.401(k)–1(e)(2) provides that, in order for a CODA to satisfy this requirement, the arrangement must provide each eligible employee with an effective opportunity to make (or change) a cash or deferred election at least once during each plan year.

Section 401(k)(2)(B) provides that a qualified CODA must provide that elective contributions may only be distributed after certain events, including hardship and severance from employment. Similar distribution restrictions apply under sections 403(b)(7) and 403(b)(11). Section 457(d)(1)(A) includes distribution restrictions for eligible governmental deferred compensation plans.

Section 401(k)(3)(A)(ii) applies a special nondiscrimination test to the elective contributions of highly compensated employees, within the meaning of section 414(q) (HCEs). Under this test, called the actual deferral percentage (ADP) test, the average percentage of compensation deferred for HCEs is compared annually to the average percentage of compensation deferred for nonhighly compensated employees (NHCEs) eligible under the plan, and if certain limits are exceeded by the HCEs, corrective action must be taken. Pursuant to section 401(k)(8), one method of correction is distribution to HCEs of excess contributions made on their behalf.

Section 401(m) provides a parallel test for matching contributions and employee after-tax contributions under a defined contribution plan, called the actual contribution percentage (ACP) test. Similarly, pursuant to section 401(m)(6), one method of correction of the ACP test is distribution to HCEs of excess aggregate contributions made on their behalf.

Sections 401(k)(12) and 401(m)(11) provide a design-based safe harbor under which a CODA and any associated matching contributions are treated as satisfying the ADP and ACP tests if the arrangement meets certain contribution and notice requirements. Sections 1.401(k)–3 and 1.401(m)–3 provide guidance on the requirements for this design-based safe harbor.

Sections 401(k)(13) and 401(m)(12), added by PPA '06 and effective for plan years beginning on or after January 1, 2008, provide an alternative design-based safe harbor for a CODA that provides for automatic contributions at a specified level of contributions and meets certain contribution, notice, and other requirements. A CODA that satisfies these requirements, referred to as a qualified automatic contribution arrangement (QACA), is treated as satisfying the ADP and ACP tests.

Section 414(w), added to the Code by section 902(d)(1) of PPA '06 and effective for plan years beginning on or after January 1, 2008, further facilitates automatic enrollment by providing limited relief from the distribution restrictions under sections 401(k)(2)(B), 403(b)(7), 403(b)(11), or 457(d)(1)(A) for an eligible automatic contribution arrangement (EACA).

Sections 414(w)(1) and 414(w)(2) provide that an applicable employer plan that contains an EACA is permitted to allow employees to elect to receive a distribution equal to the amount of elective contributions (and attributable earnings) made with respect to the employee beginning with the first payroll period to which the eligible automatic contribution arrangement applies to the employee and ending with the effective date of the election. The election must be made within 90 days after the date of the first elective contribution with respect to the employee under the arrangement. Sections 414(w)(1)(A) and 414(w)(1)(B) provide that the amount of the distribution is includible in gross income for the taxable year in which the distribution is made, but is not subject to the additional income tax under section 72(t).

Section 414(w)(3) defines an EACA as an arrangement under which: (1) a participant may elect to have the employer make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash, (2) the participant is treated as having elected to have the employer make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage), (3) in the absence of an investment election by the participant, such contributions are invested in accordance with regulations prescribed by the Secretary of Labor under section 404(c)(5) of the Employee Retirement Income Security Act of 1974 (ERISA), and (4) participants are provided a notice that satisfies the requirements of section 414(w)(4).

Section 414(w)(4) requires that, within a reasonable period before each plan year, each employee to whom the arrangement applies for such year receive written notice of the employee's rights and obli-

gations under the arrangement which is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations. Section 414(w)(4)(A)(ii) requires that the notice be written in a manner calculated to be understood by the average employee to whom the arrangement applies. Section 414(w)(4)(B) provides that the notice must explain: (1) the employee's rights under the arrangement to elect not to have elective contributions made on the employee's behalf or to elect to have contributions made at a different percentage; and (2) how contributions made under the automatic contribution arrangement will be invested in the absence of any investment decision by the employee. In addition, the employee must be given a reasonable period of time after receipt of the notice and before the first elective contribution is made to make an election with respect to contributions. In many respects, the notice under section 414(w)(4) is the same as the notice required under section 401(k)(13) for a qualified automatic contribution arrangement.

Section 414(w)(5) defines an applicable employer plan as an employee's trust described in section 401(a) that is exempt from tax under section 501(a), a plan described in section 403(b), or a section 457(b) eligible governmental plan.

Section 414(w)(6) provides that a withdrawal described in section 414(w)(1) is not to be taken into account for purposes of the ADP test.

Section 411(a)(3)(G), as amended by section 902(d)(2) of PPA '06, provides that a matching contribution shall not be treated as forfeitable merely because the matching contribution is forfeitable if it relates to a contribution that is withdrawn under an automatic contribution arrangement that satisfies the requirements of section 414(w).

Section 4979 provides an excise tax on excess contributions (within the meaning of section 401(k)(8)(B)) and excess aggregate contributions (within the meaning of section 401(m)(6)(B)) not distributed within 2½ months after the close of the plan year for which the contributions are made. Section 902 of PPA '06 amended section 4979 to lengthen this 2½ month correction period for excess contributions and excess aggregate contributions under an EACA to 6 months. Thus, in the case of an EACA, the section 4979 excise tax does not apply to any excess contributions or excess aggregate contributions which, together with income allocable to the contributions, are distributed or forfeited (if forfeitable) within six months after the close of the plan year.

Section 902 of PPA '06 amended section 4979(f)(2) to provide that any distributions of excess contributions and excess aggregate contributions are includible in the employee's gross income for the taxable year in which distributed. However, pursuant to sections 401(k)(8)(D) and 401(m)(7)(A), the distributions are not subject to the additional income tax under section 72(t). Section 902 of PPA '06 also amended sections 401(k)(8), 401(m)(6), and 4979(f)(1) to eliminate the requirement that excess contributions or excess aggregate contributions (whether or not under an EACA) include income allocable to the period after the end of the plan year (gap period income).

Section 624 of PPA '06 amended section 404(c) of ERISA to provide that a participant in an individual account plan meeting the notice requirements of section 404(c)(5)(B) of ERISA is treated as exercising control over the assets in the account which, in the absence of an investment election by the participant, are invested in accordance with regulations prescribed by the Secretary of Labor. The specific timing and content requirements for the notice required under section 404(c)(5)(B) of ERISA are generally the same as under section 414(w)(4), but the Department of Labor (DOL) has interpretative jurisdiction for that notice.

Section 902 of PPA '06 also amended section 514 of ERISA to preempt any State law which would directly or indirectly prohibit or restrict the inclusion in any plan of an automatic contribution arrangement. The Secretary of Labor is authorized to prescribe regulations which would establish minimum standards that such an arrangement would be required to satisfy in order for this preemption to apply to such an arrangement. The definition of an automatic contribution arrangement under section 514 of ERISA is generally the same as the definition of an EACA under section 414(w)(3), (including the requirement that automatic contributions under the arrangement must be invested in accordance with regulations prescribed by the Secretary of Labor under section 404(c)(5) of ERISA), but the definition does not include a notice requirement. However, section 514(e)(3) of ERISA requires a notice to be provided to each participant to whom the arrangement applies. As in the case for the notice under section 404(c)(5)(B) of ERISA, the specific timing and content requirements under section 514(e)(3) of ERISA are generally the same as the notice requirements under section 414(w)(4), but the interpretative jurisdiction for that notice is also with the DOL.

Explanation of Provisions

1. *Qualified Automatic Contribution Arrangement under Section 401(k)(13)*

The proposed regulations would amend §§1.401(k)–3 and 1.401(m)–3 to reflect the provisions of sections 401(k)(13) and 401(m)(12) for a QACA, the new design-based safe harbor for satisfying the ADP and ACP tests. To the extent that the requirements to be a QACA are the same as those for the safe harbor described in sections 401(k)(12) and 401(m)(11), these proposed regulations would apply the existing rules currently in §§1.401(k)–3 and 1.401(m)–3 to a QACA. Thus, for example, because §1.401(k)–3(e) applies to a QACA, except to the extent otherwise provided in section 1107 of PPA '06 or §1.401(k)–3(f) or §1.401(k)–3(g), the plan provision implementing the QACA for an existing qualified CODA would be required to be adopted before the first day of the plan year and remain in effect for an entire 12-month plan year. Similarly under §1.401(k)–3(c)(6), a plan would be permitted to limit the amount of elective contributions that may be made by an eligible employee under the QACA, provided that each NHCE who is an eligible employee generally is permitted to make elective contributions in an amount that is at least sufficient to receive the maximum amount of matching contributions available under the plan for the plan year, and the employee is permitted to elect any lesser amount of elective contributions.

In order to be a QACA, the plan must provide a specified schedule of automatic contributions (called qualified percentages) for each eligible employee beginning with an initial minimum qualified percentage of 3 percent of compensation.

This minimum qualified percentage begins when the employee first participates in the automatic contribution arrangement that is intended to be a QACA and ends on the last day of the following plan year. Thus, this initial period for a participant could last as long as two full plan years. After this initial period, the minimum qualified percentage increases by 1 percent for each of the next three plan years. Thus, the minimum qualified percentage for the plan year after the initial period is 4 percent. This minimum qualified percentage increases to 5 percent for the next plan year, and then is 6 percent for all plan years thereafter. These are merely minimum qualified percentages. Thus, a QACA can provide for higher percentages. For example, a QACA could provide for a qualified percentage in the initial period of 4 percent of compensation. If a plan did so, it could also provide a 4 percent qualified percentage for the plan year after the initial period (the statutory minimum percentage for that plan year), 5 percent in the next plan year and 6 percent thereafter. However, the qualified percentage can at no time exceed 10 percent of compensation.

Under section 401(k)(13)(C)(iii), the qualified percentage must be applied uniformly to all eligible employees. The proposed regulations would provide that a plan does not fail this requirement merely because the percentage varies for the following reasons: (1) the percentage varies based on the number of years an eligible employee has participated in the automatic contribution arrangement intended to be a QACA; (2) the rate of elective contributions under a cash or deferred election that is in effect on the effective date of the default percentage under the QACA is not reduced; or (3) the amount of elective contributions is limited so as not to exceed the limits of sections 401(a)(17), 402(g) (determined with or without catch-up contributions described in section 402(g)(1)(C) or section 402(g)(7)) or 415. Further, the proposed regulations would provide that a cash or deferred arrangement does not fail to satisfy the uniformity requirement merely because an employee is not automatically enrolled during a period that the employee is not permitted to make elective contributions because of the requirement to suspend elective contributions for a 6-month period following a hardship distribution. In the case of an employee whose elective contributions have been suspended (for example, because of a hardship distribution), the plan must provide that the employee will, at the end of the suspension period, resume elective contributions at the level (percentage) that would apply if the suspension had not occurred.

Reflecting section 401(k)(13)(C)(ii), the proposed regulations provide that the default election ceases to apply to any eligible employee if the employee makes an affirmative election that remains in effect to not have any elective contributions made on his or her behalf or to have elective contributions made in a specified amount or percentage of compensation on his or her behalf. Thus, an employee can make an affirmative election to contribute at a certain level and have that election apply for all subsequent plan years. Similarly, an employee can make an affirmative election to have no elective contributions made on his or her behalf. This latter election is not the same as the election to withdraw prior elective contributions under section 414(w).

The proposed regulations also reflect section 401(k)(13)(C)(iv), which provides an exception from the default election for eligible employees who were eligible to participate in the CODA (or a predecessor CODA) immediately before the effective date of the QACA and who have an election in effect on that effective date. The proposed regulations would provide that an election in effect means an affirmative election that remains in effect to have the employer make elective contributions on his or her behalf (in a specified amount or percentage of compensation) or to not have the employer make elective contributions on his or her behalf. Generally, this would require that the employee have completed an election form and chosen an amount or percentage (including zero) of his compensation to be deferred.

The proposed regulations reflect the matching or nonelective contribution requirement of section 401(k)(13)(D). As with the safe harbor in section 401(k)(12), section 401(k)(13) provides a choice for an employer between satisfying a matching contribution requirement or a nonelective contribution requirement. However, while the QACA requires the same level of employer nonelective contributions as under section 401(k)(12), the matching contribution requirement for a QACA allows for a lower level of matching contributions. Specifically, a QACA using the matching contribution alternative need only provide for matching contributions on behalf of each eligible NHCE equal to 100 percent of the employee's elective contributions that do not exceed one percent of compensation and 50 percent of the employee's elective contributions that exceed one percent but do not exceed six percent of compensation. In addition, a QACA allows a slower schedule of vesting for both matching and nonelective safe harbor contributions than the safe harbor in section 401(k)(12). All QACA safe harbor contributions must be fully vested after 2 years of vesting service (within the meaning of section 411(a)), rather than immediately as required by section 401(k)(12). In addition, the proposed regulations would apply the same distribution restrictions that apply to safe harbor contributions and nonelective contributions under section 401(k)(12) to QACA safe harbor contributions.

Each eligible employee under a QACA must receive a safe harbor notice within a reasonable period before each plan year. The proposed regulations reflect the requirement that this notice must provide the information required under section 401(k)(12). The regulations also reflect the additional timing and content requirements described in section 401(k)(13)(E)(i). Thus, the notice must also explain: (1) the employee's right under the arrangement to elect not to have elective contributions made on the employee's behalf or to elect to have contributions made in a different amount or percentage of compensation; and (2) how contributions made under the automatic contribution arrangement will be invested in the absence of any investment decision by the employee (including, in the case of an arrangement under which the employee may elect among two or more investment options, how contributions made under the automatic contribution arrangement will be invested in the absence of an investment election by the employee). These additional requirements cannot be satisfied by reference to the plan's summary plan description. Further, the proposed regulations would provide that in order to satisfy section 401(k)(13)(E)(ii)(III),

under the QACA, the employee must be given a reasonable period of time after receipt of the notice and before the first elective contribution is to be made to make an election with respect to contributions and investments.

The proposed regulations interpret the requirement under section 401(k)(13)(E)(i) to provide a notice within a reasonable period before each plan year by applying the rules of §1.401(k)–3(d)(3). Thus, the proposed regulations would provide that the general determination of whether the timing requirement is satisfied is based on all of the relevant facts and circumstances, and the deemed timing rule of §1.401(k)–3(d)(3)(ii) applies. Under this deemed timing rule, the timing requirement is satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each eligible employee for the plan year. The proposed regulations would also provide that in the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes eligible after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90 days before the employee becomes eligible (and no later than the date the employee becomes eligible). Thus, for example, the preceding sentence would apply to all eligible employees for the first plan year under a newly established plan that provides for elective contributions, and to the first plan year in which an employee becomes eligible under an existing plan that provides for elective contributions. In the case of a plan with immediate eligibility when an employee is hired, this deemed timing rule would be satisfied if the employee is provided the notice on the first day of employment.

2. *Eligible Automatic Contribution Arrangement under Section 414(w)*

In order to further facilitate automatic enrollment, section 414(w) provides limited relief from the distribution restrictions under sections 401(k)(2), 403(b)(7), 403(b)(11), and 457(d) (as well as certain other relief provisions) for an applicable plan (that is, a section 401(k) plan, a section 403(b) plan, or a section 457(b) eligible governmental plan) with an EACA. Specifically, section 414(w)(2) provides that, under an applicable employer plan with an EACA, an employee can be permitted to elect to receive a distribution equal to the amount of default elective contributions (and attributable earnings) made with respect to the first payroll period to which the EACA applies to the employee and any succeeding payroll periods beginning before the effective date of the election.

An employer is permitted, but not required, to include the section 414(w)(2) permissible withdrawal provision in an applicable employer plan, and an employer who does offer this option is not required to make it available to all employees eligible under the EACA. Thus, for example, an employer might choose to make the withdrawal option available only to employees for whom no elective contributions have been made under the CODA (or a predecessor CODA) before the EACA is effective. However, under a section 401(k) plan or a section 403(b) plan, the employer may not condition the right to take the withdrawal on the employee making an election to have no future elective contributions made on the employee's behalf because such a condition would violate the contingent benefit rule under section 401(k)(4)(A) or the universal availability requirement under section 403(b)(12)(A)(ii). Nonetheless, the employer could provide in the withdrawal election form a default election under which elective contributions would cease unless the employee makes an affirmative election.

Under section 414(w)(2)(B), the election to withdraw the contributions that were made under an EACA must be made within 90 days of the "first elective contribution with respect to the employee under the arrangement." The proposed regulations would define the arrangement for this purpose as the EACA so that the withdrawal option could apply to employees previously eligible under the CODA (including a CODA that is an automatic contribution arrangement but was not an EACA). Because section 414(w) only applies to plan years beginning on or after January 1, 2008, an automatic contribution arrangement can only become an EACA on or after that date. Accordingly, a withdrawal election under section 414(w) can only apply to elective contributions made after that date. The proposed regulations would provide that the 90-day window for making the withdrawal election begins on the date on which the compensation that is subject to the cash or deferred election would otherwise have been included in gross income. In addition, the proposed regulations would provide that the effective date of the election must be no later than the last day of the payroll period that begins after the date of the election.

The proposed regulations would provide that the distribution is generally the account balance attributable to the default elective contributions, adjusted for gains and losses. The distribution may be reduced by any generally applicable fees. However, the proposed regulations provide that the plan may not charge a different fee for this distribution than would apply to other distributions. Also, if the default elective contributions are not maintained in a separate account, the amount of the allocable gains and losses will be determined under rules similar to those provided under §1.401(k)–2(b)(2)(iv) for the distribution of excess contributions.

The amount withdrawn under section 414(w) is includible in gross income in the year in which it is distributed, except amounts that are distributions of designated Roth contributions are not included in an employee's gross income a second time. The proposed regulations would require that this amount be reported on Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* However, the amount is not subject to the additional income tax under section 72(t). Finally, the proposed regulations would amend §1.402(c)–2 to include these withdrawals in the list of distributions that are not eligible for rollover.

Any employer matching contribution with respect to the default elective contribution distributed pursuant to section 414(w) must be forfeited. The forfeited matching contribution is not a mistaken contribution or other erroneous contribution, and, thus, it cannot be returned to the employer (or be distributed to the employee as is permitted for an excess aggregate contribution). The proposed regulations would provide that the forfeited contribution must remain in the plan and be treated in the same manner under

the plan terms as any other forfeiture under the plan.

Under section 414(w)(3)(B), an EACA must provide that the default elective contribution is a uniform percentage of compensation. The proposed regulations would provide that the permitted differences in contribution rates provided in these proposed regulations under section 401(k)(13) for a QACA also apply to an EACA.

Another requirement to be an EACA under section 414(w)(3)(C) is that automatic contributions are invested in accordance with regulations prescribed by the Secretary of Labor under section 404(c)(5) of ERISA. These proposed regulations would provide that this requirement only applies if the plan is otherwise subject to Title I of ERISA. Thus, for example, this provision would not apply to a governmental plan (within the meaning of section 414(d)).

The proposed regulations reflect the section 414(w) notice requirement under which notice must be provided to each employee to whom the EACA applies within a "reasonable period" before each plan year, but provide that, if an employee becomes eligible in a given year, notice must be given within a "reasonable period" before the employee becomes eligible. The proposed regulations provide a deemed timing requirement that is generally the same as the deemed timing rule in §1.401(k)–3(d)(3)(ii).

3. *Coordinated Notices*

As noted in this preamble, PPA '06 provides for several notices relating to automatic contribution arrangements that have similar content and timing requirements, including the notices required by sections 404(c)(5)(B) and 514(e)(3) of ERISA. The IRS, in coordination with DOL, anticipates that a single document can satisfy all of these notice requirements, so long as it has all of the requisite information for plan participants and satisfies the timing requirements for each of those notices.

4. *Other Provisions of Section 902 of PPA '06*

The proposed regulations also reflect the amendments to section 4979 made by section 902 of PPA '06. First, the proposed regulations reflect the substitution of 6 months for 2½ months as the time period under section 4979(f) by which excess contributions or excess aggregate contributions with respect to an EACA must be distributed to avoid the excise tax under section 4979(a). Further, the proposed regulations reflect the elimination of the requirement that distributions of excess contributions or excess aggregate contributions (whether or not under an EACA) include attributable earnings for the period after the end of the plan year (gap period income). The proposed regulations also reflect the change in the tax treatment of a distribution of excess contributions or excess aggregate contributions (whether or not under an EACA) under which the distribution of excess contributions or excess aggregate contributions (including earnings) is includible in the participant's gross income for the year of the distribution (without regard to the amount of the distribution). The proposed regulations would also amend §§1.401(k)–2 and 1.401(m)–2 to reflect these provisions in the correction rules for the ADP and ACP tests. All of these changes are proposed to be effective January 1, 2008 and will impact corrective distributions made in 2009.

In addition, the proposed regulations would amend §§1.401(k)–2 and 1.401(m)–2 to reflect the provisions of section 414(w)(6) that default elective contributions distributed under section 414(w) are not taken into account in the ADP test. They are also not permitted to be taken into account in the ACP test. The proposed regulations under section 401(m) have added a conforming change for other elective contributions that are not taken into account in the ADP test. The proposed regulations would also amend §1.411(a)–4(b)(7) to reflect the amendment to section 411(a)(3)(G) made by PPA '06 section 902(d)(2).

Effective Date

Sections 401(k)(13), 401(m)(12), and 414(w), and the amended provisions of sections 411(a)(3)(G) and 4979(f), are effective for plan years beginning on or after January 1, 2008. These regulations are proposed to be effective for plan years beginning on or after January 1, 2008. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, the final regulations are more restrictive than the guidance in these proposed regulations, those provisions of the final regulations will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that 5 U.S.C. 533(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that most small entities that maintain plans that will be eligible for the safe harbor provisions of sections 401(k) and 401(m) or the distribution relief provisions of section 414(w) currently provide a similar notice with which this notice can be combined. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (one signed and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Dana Barry, William Gibbs, and Lisa Mojiri-Azad, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.401(k)–3 is also issued under 26 U.S.C. 401(k)(13).

Par. 2. Section 1.401(k)–0 is amended by:

1. The entry for §1.401(k)–2 is amended by adding entries for §§1.401(k)–2(a)(5)(vi) and 1.401(k)–2(b)(2)(iv)(D).

2. Revising the entries for §§1.401(k)–2(b)(2)(vi)(A) and 1.401(k)–2(b)(2)(vi)(B).

3. Adding an entry for §1.401(k)–2(b)(5)(iii).

4. Revising the entries for §§1.401(k)–3(a)(1), 1.401(k)–3(a)(2) and 1.401(k)–3(a)(3).

5. Adding entries for §§1.401(k)–3(i), 1.401(k)–3(j) through (j)(2)(iii).

6. Adding entries for §1.401(k)–3(k) through (k)(4)(iii).

The additions and revisions read as follows:

§1.401(k)–0 Table of Contents.

* * * * *

§1.401(k)–2 ADP test.

(a) * * *

(5) * * *

(vi) Default elective contributions pursuant to section 414(w).

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(A) * * *

(D) Plan years before 2008.

* * * * *

(vi) * * *

(A) Corrective distributions for plan years beginning on or after January 1, 2008.

(B) Corrective distributions for plan years beginning before January 1, 2008.

* * * * *

(5) * * *

(iii) Special rule for eligible automatic contribution arrangements.

* * * * *

§1.401(k)–3 Safe harbor requirements.

(a) * * *

(1) Section 401(k)(12) safe harbor.

(2) Section 401(k)(13) safe harbor.

(3) Requirements applicable to safe harbor contributions.

* * * * *

(i) Reserved.

(j) Qualified automatic contribution arrangement.

(1) Automatic contribution requirement.

(i) In general.

(ii) Automatic contribution arrangement.

(iii) Exception for certain current employees.

(2) Qualified percentage.

(i) In general.

(ii) Minimum percentage requirements.

(A) Initial-period requirement.

(B) Second-year requirement.

(C) Third-year requirement.

(D) Later years requirement.

(iii) Exception to uniform percentage requirement.

(k) Modifications to contribution requirements and notice requirements for automatic contribution safe harbor.

(1) In general.

(2) Lower matching requirement.

(3) Modified nonforfeiture requirement.

(4) Additional notice requirements.

(i) In general.

(ii) Additional information.

(iii) Timing requirements.

Par. 3. Section 1.401(k)–1 is amended by:

1. Revising paragraph (b)(1)(ii)(C) and adding new paragraph (b)(1)(ii)(D).

2. Revising paragraph (e)(7) by adding a new sentence after the fifth sentence.

The additions and revisions to read as follows:

§1.401(k)–1 Certain cash or deferred arrangements.

* * * * *

(b) * * * (1) * * * (ii) * * *

(C) The ADP safe harbor provisions of section 401(k)(13) described in §1.401(k)–3; or

(D) The SIMPLE 401(k) provisions of section 401(k)(11) described in §1.401(k)–4.

* * * * *

(e) * * *

(7) *Plan provision requirement.* * * * In addition, a plan that uses the safe harbor method of section 401(k)(13), as described in paragraph (b)(1)(ii)(C) of this section, must specify the default percentages that apply for the plan year, and whether the safe harbor contribution will be the nonelective safe harbor contribution or the matching safe harbor contribution and is not permitted to provide that ADP testing will be used if the requirements for the safe harbor are not satisfied. * * *

* * * * *

Par. 4. Section 1.401(k)–2 is amended by:

1. Adding paragraph (a)(5)(vi).

2. Revising paragraphs (b)(2)(iv)(A) and (b)(2)(iv)(D).

3. Removing paragraph (b)(2)(iv)(E).

4. Revising paragraph (b)(2)(vi)(A).

5. Adding a new first sentence to paragraph (b)(2)(vi)(B).

6. Removing and reserving Example (3), Example (4), and Example (5) from §1.401(k)–2 (b)(2)(viii).

7. Revising paragraph (b)(4)(iii) and adding paragraph (b)(5)(iii).

The additions and revisions to read as follows:

§1.401(k)–2 ADP test.

(a) * * *

(5) * * *

(vi) *Default elective contributions pursuant to section 414(w).* Default elective contributions made under an eligible automatic contribution arrangement (within the meaning of §1.414(w)–1(b) that are distributed pursuant to §1.414(w)–1(c) for plan years beginning on or after January 1, 2008, are not taken into account under paragraph (a)(4) of this section for the plan year for which the contributions are made, or for any other plan year.

(b) * * *

(2) * * *

(iv) *Income allocable to excess contributions*—(A) *General rule*. For plan years beginning on or after January 1, 2008, the income allocable to excess contributions is equal to the allocable gain or loss through the end of the plan year. See paragraph (b)(2)(iv)(D) of this section for rules that apply to plan years beginning before January 1, 2008.

* * * * *

(D) *Plan years before 2008.* For plan years beginning before January 1, 2008, the income allocable to excess contributions is determined under §1.401(k)–2(b)(2)(iv) (as it appeared in the April 1, 2007, edition of 26 CFR part 1).

* * * * *

(vi) *Tax treatment of corrective distributions*—(A) *Corrective distributions for plan years beginning on or after January 1, 2008.* Except as provided in this paragraph (b)(2)(vi), for plan years beginning on or after January 1, 2008, a corrective distribution of excess contributions (and allocable income) is includible in the employee's gross income for the employee's taxable year in which distributed. In addition, the corrective distribution is not subject to the early distribution tax of section 72(t). See also paragraph (b)(5) of this section for additional rules relating to the employer excise tax on amounts distributed more than 2½ months (6 months in the case of a plan that includes an eligible automatic contribution arrangement within the meaning of section 414(w)) after the end of the plan year. See also §1.402(c)–2, A–4 for restrictions on rolling over distributions that are excess contributions.

(B) *Corrective distributions for plan years beginning before January 1, 2008.* The tax treatment of corrective distributions for plan years beginning before January 1, 2008, is determined under §1.401(k)–2(b)(2)(vi) (as it appeared in the April 1, 2007, edition of 26 CFR Part 1). * * *

* * * * *

(4) * * *

(iii) *Permitted forfeiture of QMAC*. Pursuant to section 401(k)(8)(E), a qualified matching contribution is not treated as forfeitable under §1.401(k)–1(c) merely because under the plan it is forfeited in accordance with paragraph (b)(4)(ii) of this section or §1.414(w)–1(d)(2).

* * * * *

(5) * * *

(iii) *Special rule for eligible automatic contribution arrangements.* In the case of a plan that includes an eligible automatic contribution arrangement within the meaning of section 414(w), 6 months is substituted for 2½ months in paragraph (b)(5)(i) of this section.

* * * * *

Par. 5. Section 1.401(k)–3 is amended by:

1. Revising paragraph (a).
2. Revising the first sentence of paragraph (e)(1).
3. Revising the last sentence of paragraph (h)(2).
4. Revising the first sentence of paragraph (h)(3).
5. Reserving paragraph (i) and adding paragraphs (j) and (k).

The additions and revisions to read as follows:

§1.401(k)–3 Safe harbor requirements.

(a) *ADP test safe harbor*—(1) *Section 401(k)(12) safe harbor.* A cash or deferred arrangement satisfies the ADP safe harbor provision of section 401(k)(12) for a plan year if the arrangement satisfies the safe harbor contribution requirement of paragraph (b) or (c) of this section for the plan year, the notice requirement of paragraph (d) of this section, the plan year requirements of paragraph (e) of this section, and the additional rules of paragraphs (f), (g), and (h) of this section, as applicable.

(2) *Section 401(k)(13) safe harbor.* For plan years beginning on or after January 1, 2008, a cash or deferred arrangement satisfies the ADP safe harbor provision of section 401(k)(13) for a plan year if the arrangement is described in paragraph (j) of this section and satisfies the safe harbor contribution requirement of paragraph (k) of this section for the plan year, the notice requirement of paragraph (d) of this section (modified to include the information set forth in paragraph (k)(4) of this section), the plan year requirements of paragraph (e) of this section, and the additional rules of paragraphs (f), (g), and (h) of this section, as applicable. A cash or deferred arrangement that satisfies the requirements of this paragraph is referred to as a qualified automatic contribution arrangement.

(3) *Requirements applicable to safe harbor contributions.* Pursuant to section 401(k)(12)(E)(ii) and section 401(k)(13)(D)(iv), the safe harbor contribution requirement of paragraph (b), (c), or (k) of this section must be satisfied without regard to section 401(l). The contributions made under paragraph (b) or (c) of this section (and the corresponding contributions under paragraph (k) of this section) are referred to as safe harbor nonelective contributions and safe harbor matching contributions, respectively.

* * * * *

(e) * * * (1) *General rule.* Except as provided in this paragraph (e) or in paragraph (f) of this section, a plan will fail to satisfy the requirements of sections 401(k)(12), 401(k)(13), and this section unless plan provisions that satisfy the rules of this section are adopted before the first day of the plan year and remain in effect for an entire 12-month plan year. * * *

* * * * *

(h) * * *

(2) *Use of safe harbor nonelective contributions to satisfy other discrimination tests.* * * * However, pursuant to section 401(k)(12)(E)(ii) and section 401(k)(13)(D)(iv), to the extent they are needed to satisfy the safe harbor contribution requirement of paragraph (b) of this section, safe harbor nonelective contributions may not be taken into account under any plan for purposes of section 401(l) (including the imputation of permitted disparity under §1.401(a)(4)–7).

(3) *Early participation rules.* Section 401(k)(3)(F) and §1.401(k)–2(a)(1)(iii)(A), which provide an alternative nondiscrimination rule for certain plans that provide for early participation, do not apply for purposes

of section 401(k)(12), section 401(k)(13), and this section. * * *

* * * * *

(i) [RESERVED].

(j) *Qualified automatic contribution arrangement*—(1) *Automatic contribution requirement*—(i) *In general.* A cash or deferred arrangement is described in this paragraph (j) if it is an automatic contribution arrangement described in paragraph (j)(1)(ii) of this section where the default election under that arrangement is a contribution equal to the qualified percentage described in paragraph (j)(2) of this section multiplied by the eligible employee's compensation from which elective contributions are permitted to be made under the cash or deferred arrangement.

(ii) *Automatic contribution arrangement.* An automatic contribution arrangement is a cash or deferred arrangement within the meaning of §1.401(k)–1(a)(2) that provides that in the absence of an eligible employee's affirmative election, a default applies under which the employee is treated as having made an election to have a specified contribution made on his or her behalf under the plan. The default election ceases to apply with respect to an eligible employee if the employee makes an affirmative election (that remains in effect) to—

(A) Have elective contributions made in a different amount on his or her behalf (in a specified amount or percentage of compensation); or

(B) Not have any elective contributions made on his or her behalf.

(iii) *Exception for certain current employees.* An automatic contribution arrangement will not fail to be a qualified automatic contribution arrangement merely because the default election provided under paragraph (j)(1)(i) of this section is not applied to an employee who was an eligible employee under the cash or deferred arrangement (or a predecessor arrangement) immediately prior to the effective date of the qualified automatic contribution arrangement and on that effective date had an affirmative election in effect (that remains in effect) to—

(A) Have elective contributions made on his or her behalf (in a specified amount or percentage of compensation); or

(B) Not have elective contributions made on his or her behalf.

(2) *Qualified percentage*—(i) *In general.* A percentage is a qualified percentage only if it—

(A) Is uniform for all employees (except to the extent provided in paragraph (j)(2)(iii) of this section);

(B) Does not exceed 10 percent; and

(C) Satisfies the minimum percentage requirements of paragraph (j)(2)(ii) of this section.

(ii) *Minimum percentage requirements*—(A) *Initial-period requirement.* The minimum percentage requirement of this paragraph (j)(2)(ii)(A) is satisfied only if the percentage that applies for the period that begins when the employee first participates in the automatic contribution arrangement that is a qualified automatic contribution arrangement and ends on the last day of the following plan year is at least 3 percent.

(B) *Second-year requirement.* The minimum percentage requirement of this paragraph (j)(2)(ii)(B) is satisfied only if the percentage that applies for the plan year immediately following the last day described in paragraph (j)(2)(ii)(A) of this section is at least 4 percent.

(C) *Third-year requirement.* The minimum percentage requirement of this paragraph (j)(2)(ii)(C) is satisfied only if the percentage that applies for the plan year immediately following the plan year described in paragraph (j)(2)(ii)(B) of this section is at least 5 percent.

(D) *Later years requirement.* A percentage satisfies the minimum percentage requirement of this paragraph (j)(2)(ii)(D) only if the percentage that applies for all plan years following the plan year described in paragraph (j)(2)(ii)(C) of this section is at least 6 percent.

(iii) *Exception to uniform percentage requirement.* A plan does not fail to satisfy the uniform percentage requirement of paragraph (j)(2)(i)(A) of this section merely because—

(A) The percentage varies based on the number of years an eligible employee has participated in the automatic contribution arrangement intended to be a qualified automatic contribution arrangement;

(B) The rate of elective contributions under a cash or deferred election that is in effect immediately prior to the effective date of the default percentage under the qualified automatic contribution arrangement is not reduced;

(C) The rate of elective contributions is limited so as not to exceed the limits of sections 401(a)(17), 402(g) (determined with or without catch-up contributions described in section 402(g)(1)(C) or 402(g)(7)), and 415; or

(D) The default election provided under paragraph (j)(1)(i) of this section is not applied during the period an employee is not permitted to make elective contributions in order for the plan to satisfy the requirements of §1.401(k)–1(d)(3)(iv)(E)(*2*).

(k) *Modifications to contribution requirements and notice requirements for automatic contribution safe harbor*—(1) *In general.* A cash or deferred arrangement satisfies the contribution requirements of this paragraph (k) only if it satisfies the contribution requirements of either paragraph (b) or (c) of this section, as modified by the rules of paragraphs (k)(2) and (k)(3) of this section. In addition, a cash or deferred arrangement described in paragraph (j) of this section satisfies the notice requirement of section 401(k)(13)(E) only if the notice satisfies the additional requirements of paragraph (k)(4) of this section.

(2) *Lower matching requirement.* In applying the requirement of paragraph (c) of this section, in the case of a cash or deferred arrangement described in paragraph (j) of this section, the basic matching formula is modified so that each eligible NHCE must receive the sum of—

(i) 100 percent of the employee's elective contributions that do not exceed 1 percent of the employee's safe harbor compensation; and

(ii) 50 percent of the employee's elective contributions that exceed 1 percent of the employee's safe harbor compensation but that do not exceed 6 percent of the employee's safe harbor compensation.

(3) *Modified nonforfeiture requirement.* A cash or deferred arrangement described in paragraph (j) of this section will not fail to satisfy the requirements of paragraph (b) or (c) of this section, as applicable, merely because the safe harbor contributions are not qualified nonelective contributions or qualified matching contributions provided that—

(i) The contributions are subject to the withdrawal restrictions set forth in §1.401(k)–1(d); and

(ii) Any employee who has completed 2 years of service (within the meaning of

section 411(a)) has a nonforfeitable right to the account balance attributable to the safe harbor contributions.

(4) *Additional notice requirements*—(i) *In general.* A notice satisfies the requirements of this paragraph (k)(4) only if it includes the additional information described in paragraph (k)(4)(ii) of this section and satisfies the timing requirements of paragraph (k)(4)(iii) of this section.

(ii) *Additional information.* A notice satisfies the additional information requirement of this paragraph (k)(4)(ii) only if it explains—

(A) The level of elective contributions which will be made on the employee's behalf if the employee does not make an affirmative election;

(B) The employee's right under the automatic contribution arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made in a different amount or percentage of compensation); and

(C) How contributions under the automatic contribution arrangement will be invested (including, in the case of an arrangement under which the employee may elect among 2 or more investment options, how contributions made under the automatic contribution arrangement will be invested in the absence of an investment election by the employee).

(iii) *Timing requirements.* A notice satisfies the timing requirements of this paragraph (k)(4)(iii) only if it is provided sufficiently early so that the employee has a reasonable period of time after receipt of the notice and before the first elective contribution is made under the arrangement to make the elections described under paragraph (k)(4)(ii)(B) and (C) of this section.

* * * * *

Par. 6. Section 1.401(k)–6 is amended by revising the last sentence in the definition of Qualified matching contributions (QMACs) to read as follows:

§1.401(k)–6 Definitions.

* * * * *

Qualified matching contributions (QMACs). * * * See also §1.401(k)–2(b)(4)(iii) for a rule providing that a matching contribution does not fail to qualify as a QMAC solely because it is forfeitable under section 411(a)(3)(G) as a result of being a matching contribution with respect to an excess deferral, excess contribution, excess aggregate contribution, or it is forfeitable under §1.414(w)–1(d)(2).

* * * * *

Par. 7. Section 1.401(m)–0 is amended to read as follows:

Adding an entry for §1.401(m)–2(b)(4)(iii).

§1.401(m)–0 Table of Contents.

* * * * *

§1.401(m)–2 ACP Test.

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(A) * * *

(D) Plan years before 2008.

* * * * *

(4) * * *

(iii) *Special rule for eligible automatic contribution arrangements.*

* * * * *

Par. 8. Section 1.401(m)–1 is amended by:

1. Revising paragraph (b)(1)(iii) and adding paragraph (b)(1)(iv).

2. Revising the last sentence of paragraph (b)(4)(iii)(B).

3. Revising the fifth sentence of paragraph (c)(2).

The additions and revisions to read as follows:

§1.401(m)–1 Employee contributions and matching contributions.

* * * * *

(b) * * *

(1) * * *

(iii) The ACP safe harbor provisions of section 401(m)(12) described in §1.401(m)–3; or

(iv) The SIMPLE 401(k) provisions of sections 401(k)(11) and 401(m)(10) described in §1.401(k)–4.

* * * * *

(b) * * *

(4) * * *

(iii) * * *

(B) *Arrangements with inconsistent ACP testing methods.* * * * Similarly, an employer may not aggregate a plan (within the meaning of §1.410(b)–7) that is using the ACP safe harbor provisions of section 401(m)(11) or 401(m)(12) and another plan that is using the ACP test of section 401(m)(2).

* * * * *

(c) * * *

(2) *Plan provision requirement.* * * * Similarly, a plan that uses the safe harbor method of section 401(m)(11) or 401(m)(12), as described in paragraphs (b)(1)(ii) and (b)(1)(iii) of this section, must specify the default percentages that apply for the plan year and whether the safe harbor contribution will be the nonelective safe harbor contribution or the matching safe harbor contribution and is not permitted to provide that ACP testing will be used if the requirements for the safe harbor are not satisfied. * * *

* * * * *

Par. 9. Section 1.401(m)–2 is amended by:

1. Revising the first and second sentences of paragraph (a)(5)(iv).

2. Revising paragraph (a)(5)(v).

3. Adding a new sentence to the end of paragraph (a)(6)(ii).

4. Revising paragraphs (b)(2)(iv)(A) and (b)(2)(iv)(D).

5. Removing paragraph (b)(2)(iv)(E).

6. Revising paragraph (b)(2)(vi)(A).

7. Adding a new sentence to the beginning of paragraph (b)(2)(vi)(B).

8. Adding paragraph (b)(4)(iii).

The additions and revisions to read as follows:

§1.401(m)–2 ACP test.

(a) * * * * *

(5) * * * * *

(iv) *Matching contributions taken into account.* A plan that satisfies the ACP safe harbor requirements of section 401(m)(11) or 401(m)(12) for a plan year but nonetheless must satisfy the requirements of this section because it provides for employee contributions for such plan year is permitted to apply this section disregarding all matching contributions with respect to all eligible employees. In addition, a plan that satisfies the ADP safe harbor requirements of §1.401(k)–3 for a plan year using qualified matching contributions but does not satisfy the ACP safe harbor requirements of section 401(m)(11) or 401(m)(12) for such plan year is permitted to apply this section by excluding matching contribu-

tions with respect to all eligible employees that do not exceed 4 percent (3.5 percent in the case of a plan that satisfies the ADP safe harbor under section 401(k)(13)) of each employee's compensation. * * *

(v) *Treatment of forfeited matching contributions.* A matching contribution that is forfeited because the contribution to which it relates is treated as an excess contribution, excess deferral, excess aggregate contribution, or a default elective contribution that is distributed under section 414(w), is not taken into account for purposes of this section.

* * * * *

(6) * * * * *

(ii) *Elective contributions taken into account under the ACP test.* * * * In addition, for plan years ending on or after November 8, 2007, elective contributions which are not permitted to be taken into account for the ADP test for the plan year under §1.401(k)–2(a)(5)(ii), (iii), (v), or (vi) are not permitted to be taken into account for the ACP test.

* * * * *

(b) * * * * *

(2) * * * * *

(iv) *Income allocable to excess aggregate contributions*—(A) *General rule.* For plan years beginning on or after January 1, 2008, the income allocable to excess aggregate contributions is equal to the allocable gain or loss through the end of the plan year. See paragraph (b)(2)(iv)(D) of this section for rules that apply to plan years beginning before January 1, 2008.

* * * * *

(D) *Plan years before 2008.* For plan years beginning before January 1, 2008, the income allocable to excess aggregate contributions is determined under §1.401(m)–2(b)(2)(iv) (as it appeared in the April 1, 2007, edition of 26 CFR part 1).

* * * * *

(vi) *Tax treatment of corrective distributions*—(A) *Corrective distributions for plan years beginning on or after January 1, 2008.* Except as otherwise provided in this paragraph (b)(2)(vi), for plan years beginning on or after January 1, 2008, a corrective distribution of excess aggregate contributions (and allocable income) is includible in the employee's gross income in the taxable year of the employee in which distributed. The portion of the distribution that is treated as an investment in the contract and is therefore not subject to tax under section 72 is determined without regard to any plan contributions other than those distributed as excess aggregate contributions. Regardless of when the corrective distribution is made, it is not subject to the early distribution tax of section 72(t). See paragraph (b)(4) of this section for additional rules relating to the employer excise tax on amounts distributed more than 2½ months (6 months in the case of a plan that includes an eligible automatic contribution arrangement within the meaning of section 414(w)) after the end of the plan year. See also §1.402(c)–2, A–4 prohibiting rollover of distributions that are excess aggregate contributions.

(B) *Corrective distributions for plan years beginning before January 1, 2008.* The tax treatment of corrective distributions for plan years beginning before January 1, 2008, is determined under §1.401(m)–2(b)(2)(vi) (as it appeared in the April 1, 2007, edition of 26 CFR Part 1). * * *

(4) * * *

(iii) *Special rule for eligible automatic contribution arrangements.* In the case of a plan that includes an eligible automatic contribution arrangement (within the meaning of section 414(w)), 6 months is substituted for 2½ months in paragraph (b)(4)(i) of this section.

* * * * *

Par. 10. Section 1.401(m)–3 is amended by:

1. Revising paragraph (a).
2. Revising the first sentences of paragraphs (f)(1) and (j)(3).

The additions and revisions to read as follows:

§1.401(m)–3 Safe harbor requirements.

(a) *ACP test safe harbor*—(1) *Section 401(m)(11) safe harbor.* Matching contributions under a plan satisfy the ACP safe harbor provisions of section 401(m)(11) for a plan year if the plan satisfies the safe harbor contribution requirement of paragraph (b) or (c) of this section for the plan year, the limitations on matching contributions of paragraph (d) of this section, the notice requirement of paragraph (e) of this section, the plan year requirements of paragraph (f) of this section, and the additional rules of paragraphs (g), (h) and (j) of this section, as applicable.

(2) *Section 401(m)(12) safe harbor.* For a plan year beginning on or after January 1, 2008, matching contributions under a plan satisfy the ACP safe harbor provisions of section 401(m)(12) for a plan year if the matching contributions are made with respect to a qualified automatic contribution arrangement described in paragraph §1.401(k)–3(j) that satisfies the safe harbor requirements of §1.401(k)–3, the limitations on matching contributions of paragraph (d) of this section, the notice requirement of paragraph (e) of this section, the plan year requirements of paragraph (f) of this section, and the additional rules of paragraphs (g), (h) and (j) of this section, as applicable.

(3) *Requirements applicable to safe harbor contributions.* Pursuant to sections 401(k)(12)(E)(ii) and 401(k)(13)(D)(iv), the safe harbor contribution requirement of paragraph (b) or (c) of this section, and §1.401(k)–3(k) must be satisfied without regard to section 401(l). The contributions made under paragraphs (b) and (c) of this section, and §1.401(k)–3(k) are referred to as safe harbor nonelective contributions and safe harbor matching contributions.

* * * * *

(f) *Plan year requirement*—(1) *General rule.* Except as provided in this paragraph (f) or in paragraph (g) of this section, a plan will fail to satisfy the requirements of section 401(m)(11), section 401(m)(12), and this section unless plan provisions that satisfy the rules of this section are adopted before the first day of that plan year and remain in effect for an entire 12-month plan year. * * *

* * * * *

(j) * * *

(3) *Early participation rules.* Section 401(m)(5)(C) and §1.401(m)–2(a)(1)(iii)(A), which provide an alternative nondiscrimination rule for certain plans that provide for early participation, do not apply for purposes of section 401(m)(11), section 401(m)(12), and this section. * * *

* * * * *

Par. 11. Section 1.402(c)–2, A–4 is amended by redesignating paragraph (i) as

(j) and adding a new paragraph (i) to read as follows:

§1.402(c)–2 Eligible rollover distributions, questions and answers.

* * * * *

A–4 * * *

(i) A distribution that is a permissible withdrawal from an eligible automatic contribution arrangement within the meaning of section 414(w).

* * * * *

Par. 12. Section 1.411(a)–4 is amended by revising paragraph (b)(7) to read as follows:

§1.411(a)–4 Forfeitures, suspensions, etc.

* * * * *

(b) * * *

(7) *Certain matching contributions.* A matching contribution (within the meaning of section 401(m)(4)(A) and §1.401(m)–1(a)(2)) is not treated as forfeitable even if under the plan it may be forfeited under §1.401(m)–2(b)(1) because the contribution to which it relates is treated as an excess contribution (within the meaning of §1.401(k)–2(b)(2)(ii) and 1.401(k)–6), excess deferral (within the meaning of §1.402(g)–1(e)(1)(iii)), excess aggregate contribution (within the meaning of §1.401(m)–5), or default elective contributions (within the meaning of §1.414(w)–1(e)) that are withdrawn in accordance with the requirements of §1.414(w)–1(c).

Par. 13. Section 1.414(w)–1 is added to read as follows:

§1.414(w)–1 Permissible Withdrawals from Eligible Automatic Contribution Arrangements.

(a) *Overview.* Section 414(w) provides rules under which certain employees are permitted to elect to make a withdrawal from an eligible automatic contribution arrangement. This section sets forth the rules applicable to permissible withdrawals from an eligible automatic contribution arrangement within the meaning of section 414(w). Paragraph (b) of this section defines an eligible automatic contribution arrangement. Paragraph (c) of this section describes a permissible withdrawal and addresses which employees are eligible to elect a withdrawal, the timing of the withdrawal election, and the amount of the withdrawal. Paragraph (d) of this section describes the tax and other consequences of the withdrawal. Paragraph (e) of this section includes the definitions applicable to this section.

(b) *Eligible automatic contribution arrangement*—(1) *In general.* An eligible automatic contribution arrangement is an automatic contribution arrangement under an applicable employer plan that, for the plan year, satisfies the uniformity requirement under paragraph (b)(2) of this section, the notice requirement under paragraph (b)(3) of this section, and the default investment requirement under (b)(4) of this section.

(2) *Uniformity requirement.* An eligible automatic contribution arrangement must provide that the default elective contribution is a uniform percentage of compensation. An arrangement does not violate the uniformity requirement of this paragraph (b)(2) merely because the percentage varies in a manner that is permitted under §1.401(k)–3(j)(2)(iii), except that the rules of §§1.401(k)–3(j)(2)(iii)(A) and 1.401(k)–3(j)(2)(iii)(B) are applied without regard to whether the arrangement is intended to be a qualified automatic contribution arrangement.

(3) *Notice requirement*—(i) *General rule.* The notice requirement of this paragraph (b)(3) is satisfied for a plan year if each eligible employee is given notice of the employee's rights and obligations under the arrangement. The notice must be sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and be written in a manner calculated to be understood by the average employee to whom the arrangement applies. The notice must be in writing, however, see §1.401(a)–21 for rules permitting the use of electronic media to provide applicable notices.

(ii) *Content requirement.* The notice must include the provisions found in §1.401(k)–3(d)(2)(ii) to the extent those provisions apply to the arrangement. A notice is not considered sufficiently accurate and comprehensive unless the notice accurately describes—

(A) The level of elective contributions which will be made on the employee's behalf if the employee does not make an affirmative election;

(B) The employee's rights to elect not to have default elective contributions made to the plan on his or her behalf or to have a different percentage of compensation or amount of elective contributions made to the plan on his or her behalf;

(C) How contributions made under the arrangement will be invested in the absence of any investment election by the employee; and

(D) The employee's rights to make a permissible withdrawal, if applicable, and the procedures to elect such a withdrawal.

(iii) *Timing*—(A) *General rule.* The timing requirement of this paragraph (b)(3)(iii) is satisfied if the notice is provided within a reasonable period before the beginning of each plan year (or, in the year an employee becomes an eligible employee, within a reasonable period before the employee becomes an eligible employee). In addition, a notice satisfies the timing requirements of paragraph (b)(3) of this section only if it is provided sufficiently early so that the employee has a reasonable period of time after receipt of the notice and before the first elective contribution is made under the arrangement to make the election described under paragraph (b)(ii)(A) of this section.

(B) *Deemed satisfaction of timing requirement.* The timing requirement of this paragraph (b)(3)(iii) is satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each eligible employee for the plan year. In the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes an eligible employee after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90 days before the employee becomes an eligible employee (and no later than the date the employee becomes an eligible employee).

(4) *Default investment requirement.* To the extent the plan is subject to Title I of ERISA, default elective contributions under an eligible automatic contribution arrangement must be invested in accordance with regulations prescribed by the Secretary of Labor under section 404(c)(5) of ERISA.

(c) *Permissible withdrawal*—(1) *In general.* If the plan provides, any employee who has default elective contribu-

tions made under the eligible automatic contribution arrangement may elect to make a withdrawal of such contributions (and earnings attributable thereto) in accordance with the requirements of this paragraph (c). An applicable employer plan that includes an eligible automatic contribution arrangement will not fail to satisfy the prohibition on in-service withdrawals under sections 401(k)(2)(B), 403(b)(7), 403(b)(11), or 457(d)(1) merely because it permits withdrawals that satisfy the timing requirement of paragraph (c)(2) of this section and the amount requirement of paragraph (c)(3) of this section.

(2) *Timing*. The election to withdraw default elective contributions must be made no later than 90 days after the date of the first default elective contribution under the eligible automatic contribution arrangement. The date of the first default elective contribution is the date that the compensation that is subject to the cash or deferred election would otherwise have been included in gross income. The effective date of an election described in this paragraph (c)(2) cannot be later than the last day of the payroll period that begins after the date the election is made.

(3) *Amount of distributions*—(i) *In general*. A distribution satisfies the requirement of this paragraph (c)(3) if the distribution is equal to the amount of default elective contributions made under the eligible automatic contribution arrangement through the effective date of the election described in paragraph (c)(2) of this section (adjusted for allocable gains and losses to the date of distribution). If default elective contributions are separately accounted for in the participant's account, the amount of the distribution will be the total amount in that account. However, if default elective contributions are not separately accounted for under the plan, the amount of the allocable gains and losses will be determined under rules similar to those provided under §1.401(k)–2(b)(2)(iv) for the distribution of excess contributions.

(ii) *Fees*. The distribution amount as determined under this paragraph (c)(3) may be reduced by any generally applicable fees. However, the plan may not charge a different fee for a distribution under section 414(w) than applies to other distributions.

(d) *Consequences of the withdrawal*—(1) *Income tax consequences*—(i) *Year of inclusion*. The amount of the withdrawal is includible in the eligible employee's gross income for the taxable year in which the distribution is made. However, the portion of the distribution consisting of designated Roth contributions is not included in an employee's gross income a second time. The portion of the withdrawal that is treated as an investment in the contract is determined without regard to any plan contributions other than those distributed as withdrawal default elective contributions.

(ii) *No additional tax on early distributions from qualified retirement plans*. The withdrawal is not subject to the additional tax under section 72(t).

(iii) *Reporting*. The amount of the withdrawal is reported on Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, as described in the applicable instructions.

(2) *Forfeiture of matching contributions*. In the case of any withdrawal made under paragraph (c) of this section, employer matching contributions with respect to the amount withdrawn must be forfeited.

(3) *Consent rules*. A withdrawal made under paragraph (c) of this section may be made without regard to any notice or consent otherwise required under section 401(a)(11) or 417.

(e) *Definitions*. Unless indicated otherwise, the following definitions apply for purposes of section 414(w) and this section.

(1) *Applicable employer plan*. An applicable employer plan means a plan that—

(i) Is qualified under section 401(a);

(ii) Satisfies the requirements of section 403(b); or

(iii) Is a section 457(b) eligible governmental plan described in §1.457–2(f).

(2) *Automatic contribution arrangement*. An automatic contribution arrangement means an arrangement that provides for a cash or deferred election that provides that in the absence of an eligible employee's affirmative election, a default election applies under which the employee is treated as having elected to have default elective contributions made on his or her behalf under the plan. This default election ceases to apply with respect to an employee if the employee makes an affirmative election (that remains in effect) to—

(i) Not have any default elective contributions made on his or her behalf; or

(ii) Have default elective contributions made in a different amount or percentage of compensation.

(3) *Default elective contributions*. Default elective contributions means contributions made at a specified level or amount under an automatic contribution arrangement that are—

(i) Contributions described in section 402(g)(3)(A) or 402(g)(3)(C); or

(ii) Contributions made pursuant to a cash or deferred election within the meaning of section 457(b)(4) where the contributions are under a section 457(b) eligible governmental plan.

(4) *Eligible employee*. An eligible employee means an employee who is eligible to make a cash or deferred election under the plan.

(f) *Effective date*. Section 414(w) and this section apply to plan years beginning on or after January 1, 2008.

* * * * *

PART 54—EXCISE TAXES. PENSIONS, REPORTING AND RECORDKEEPING REQUIREMENTS

Par. 14. The authority citation for part 54 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 15. Section 54.4979–1(c)(1) is amended by:

Revising the first and second sentences of paragraph (c)(1) to read as follows:

§54.4979–1 Excise tax on certain excess contributions and excess aggregate contributions.

* * * * *

(c) *No tax when excess distributed within 2½ months of close of year or additional employer contributions made*—(1) *General rule*. No tax is imposed under this section on any excess contribution or excess aggregate contribution, as the case may be, to the extent the contribution (together with any income allocable thereto) is corrected before the close of the first 2½ months of the following plan year (6 months in the case of a plan that

includes an eligible automatic contribution arrangement within the meaning of section 414(w)). Qualified nonelective contributions and qualified matching contributions taken into account under §1.401(k)–2(a)(6) of this Chapter or qualified nonelective contributions or elective contributions taken into account under §1.401(m)–2(a)(6) of this Chapter for a plan year may permit a plan to avoid excess contributions or excess aggregate contributions, respectively, even if made after the close of the $2^1/_2$ month period (6 months in the case of a plan that includes an eligible automatic contribution arrangement within the meaning of section 414(w)). * * *

* * * * *

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 7, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 8, 2007, 72 F.R. 63144)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–111

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on December 3, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

First Step Consumer
Credit Counseling, Inc.
Macunle, PA
Sterling Debt Management, Inc.
Los Angeles, CA
Community Partners Corporation
Las Vegas, NV
The Senior Citizens Counseling
and Delivery Service
Washington, DC
Elaine R. Shepard Cancer
Research Foundation
Coronado, CA
The Dowd Foundation
Wilkes-Barre, PA
Western Arkansas Housing Fdn
Ft. Smith, AR
Pythons Drill Team
Kansas City, MO
Buddy and Rita Gregory Charitable
Supporting Organization
Lehi, UT
Down Payment Assistance
Foundation, Inc.
Glendora, CA
Market 5 Gallery
Washington, DC
IJM Foundation
Syosset, NY
International Charities of Nevada
Las Vegas, NV
First Bingo Cooperative Association
Austin, TX
One America Foundation, Inc.
Baltimore, MD
Future Homes Assistance Programs, Inc.
Stockbridge, GA
Sweet Home Foundation
Caldwell, ID
Housing Opportunities of Houston Inc.
Houston, TX

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213–1: Medical, dental, etc., expenses.

Diagnostic medical procedures. This ruling holds that amounts paid by individuals for certain diagnostic and similar procedures and devices are medical care expenses deductible under section 213 of the Code.

Rev. Rul. 2007–72

ISSUE

Are amounts paid by individuals for diagnostic and certain similar procedures and devices, not compensated by insurance or otherwise, medical care expenses deductible under § 213(a) of the Internal Revenue Code?

FACTS

In the situations described below, the costs paid by the taxpayers are not compensated by insurance or otherwise, and the taxpayers are not experiencing any symptoms of illness.

Situation 1

Taxpayer *A* undergoes an annual physical examination, which is performed by a physician. *A* pays for the physician's services and laboratory tests.

Situation 2

Taxpayer *B* pays for a full-body electronic scan, a relatively high-cost procedure, performed by a technician at a clinic. The scan examines the condition of *B*'s internal organs and may identify disease or other abnormalities. *B* has not consulted a physician before undergoing the procedure, which can be obtained without a physician's direction, or determined if less expensive alternatives are available.

Situation 3

Taxpayer *C* buys a test kit and uses it to determine whether she is pregnant.

LAW

Section 213(a) allows a deduction for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, spouse, or dependent, to the extent that the expenses exceed 7.5 percent of adjusted gross income. Medical care includes amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Section 213(d)(1)(A).

Medical care includes X-rays and laboratory and other diagnostic services. Amounts paid for obstetrical services are deemed to be for the purpose of affecting a structure or function of the body and therefore are paid for medical care. Section 1.213–1(e)(1)(ii) of the Income Tax Regulations.

"Diagnosis" is the determination of a medical condition, such as a disease, by physical examination or study of symptoms. *Black's Law Dictionary* (8th ed., 2004). A diagnosis may encompass a determination that disease is absent. The determination of a medical condition may include testing for changes in the functions of the body, such as those resulting from pregnancy, that are unrelated to disease.

In determining whether an expense is for either medical or personal reasons, the recommendation of a physician is important. *Havey v. Commissioner*, 12 T.C. 409, 412 (1949). However, this determination is unnecessary in the case of expenses for items that are wholly medical in nature and serve no other function in everyday life. *Stringham v. Commissioner*, 12 T.C. 580, 584 (court reviewed), *aff'd* 183 F.2d 579 (6th Cir. 1950).

The amount of the deduction under § 213 is not limited by a ceiling and, although additional costs for personal convenience are not allowable, § 213 does not limit the deduction to amounts paid for the least expensive form of medical care available. *Ferris v. Commissioner*, 582 F.2d 1112, 1116 (7th Cir. 1978).

ANALYSIS

In *Situation 1*, the amount *A* pays for the annual physical examination is for diagnosis and qualifies as an expense for medical care even though *A* is not experiencing any symptoms of illness.

In *Situation 2*, the amount *B* pays for the full-body scan is for diagnosis and qualifies as an expense for medical care even though *B* is not experiencing symptoms of illness and has not obtained a physician's recommendation before undergoing the procedure. The procedure serves no non-medical function and the expense is not disallowed because of the high cost or possible existence of less expensive alternatives.

In *Situation 3*, the amount *C* pays for the pregnancy test qualifies as an expense for medical care even though its purpose is to test the healthy functioning of the body rather than to detect disease.

Therefore, the amounts paid by Taxpayers *A*, *B*, and *C* for the physical examination, the full-body scan, and the pregnancy test kit are deductible under § 213(a), subject to the 7.5 percent floor.

HOLDING

Amounts paid by individuals for diagnostic and certain similar procedures and devices, not compensated by insurance or otherwise, are medical care expenses deductible under § 213(a), subject to the limitations of that section.

DRAFTING INFORMATION

For further information regarding this revenue ruling, contact Dan Cassano at (202) 622–7900 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(l)–1: Permitted disparity in employer-provided contributions or benefits.

2008 covered compensation tables; permitted disparity. The covered compensation tables under section 401 of the Code for the year 2008 are provided for use in determining contributions to defined benefit plans and permitted disparity.

Rev. Rul. 2007–71

This revenue ruling provides tables of covered compensation under § 401(l)(5)(E) of the Internal Revenue Code (the "Code") and the Income Tax Regulations, thereunder, for the 2008 plan year.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the "Act") for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)–1(c)(34) defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(l)–1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)–1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(l)–1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2008 year the taxable wage base is $102,000.

The following tables provide covered compensation for 2008:

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1907	1972	$4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232
1920	1985	12,276
1921	1986	13,368

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,212
1937	2002	39,444
1938	2004	43,992
1939	2005	46,344
1940	2006	48,816
1941	2007	51,348
1942	2008	53,952
1943	2009	56,484
1944	2010	58,992
1945	2011	61,476
1946	2012	63,912
1947	2013	66,324
1948	2014	68,580
1949	2015	70,764
1950	2016	72,828
1951	2017	74,820
1952	2018	76,704
1953	2019	78,540
1954	2020	80,328
1955	2022	83,700
1956	2023	85,332
1957	2024	86,880
1958	2025	88,320
1959	2026	89,712
1960	2027	91,044
1961	2028	92,304
1962	2029	93,492
1963	2030	94,656
1964	2031	95,784
1965	2032	96,828
1966	2033	97,788
1967	2034	98,628
1968	2035	99,360
1969	2036	99,984
1970	2037	100,464
1971	2038	100,896

ATTACHMENT I

2008 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2008 COVERED COMPENSATION TABLE II
1972	2039	101,304
1973	2040	101,640
1974	2041	101,868
1975 and Later	2042	102,000

2008 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1937	39,000
1938 - 1939	45,000
1940	48,000
1941	51,000
1942	54,000
1943	57,000
1944 - 1945	60,000
1946	63,000
1947	66,000
1948	69,000
1949 - 1950	72,000
1951	75,000
1952 - 1953	78,000
1954	81,000
1955 - 1956	84,000
1957 - 1958	87,000
1959 - 1960	90,000
1961 - 1962	93,000
1963 - 1965	96,000
1966 - 1970	99,000
1971 and Later	102,000

DRAFTING INFORMATION

The principal author of this revenue ruling is Wayne Bradley of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans taxpayer assistance telephone service at 1–877–829–5500, between the hours of 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday (a toll-free number). Mr. Bradley may be reached via e-mail at *RetirementPlanQuestions@irs.gov*.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for December 2007.

Rev. Rul. 2007–70

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2007 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2008 interest rate for sections 846 and 807.

REV. RUL. 2007–70 TABLE 1

Applicable Federal Rates (AFR) for December 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	3.88%	3.84%	3.82%	3.81%
110% AFR	4.26%	4.22%	4.20%	4.18%
120% AFR	4.66%	4.61%	4.58%	4.57%
130% AFR	5.05%	4.99%	4.96%	4.94%
Mid-term				
AFR	4.13%	4.09%	4.07%	4.06%
110% AFR	4.55%	4.50%	4.47%	4.46%
120% AFR	4.97%	4.91%	4.88%	4.86%
130% AFR	5.39%	5.32%	5.29%	5.26%
150% AFR	6.23%	6.14%	6.09%	6.06%
175% AFR	7.29%	7.16%	7.10%	7.06%
Long-term				
AFR	4.72%	4.67%	4.64%	4.63%
110% AFR	5.21%	5.14%	5.11%	5.09%
120% AFR	5.68%	5.60%	5.56%	5.54%
130% AFR	6.16%	6.07%	6.02%	5.99%

REV. RUL. 2007–70 TABLE 2

Adjusted AFR for December 2007

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.40%	3.37%	3.36%	3.35%
Mid-term adjusted AFR	3.67%	3.64%	3.62%	3.61%
Long-term adjusted AFR	4.34%	4.29%	4.27%	4.25%

REV. RUL. 2007–70 TABLE 3

Rates Under Section 382 for December 2007

Adjusted federal long-term rate for the current month	4.34%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.49%

REV. RUL. 2007–70 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2007

Appropriate percentage for the 70% present value low-income housing credit	8.03%
Appropriate percentage for the 30% present value low-income housing credit	3.44%

REV. RUL. 2007–70 TABLE 5

Rate Under Section 7520 for December 2007

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.0%

REV. RUL. 2007–70 TABLE 6

Applicable rate of interest for 2008 for purposes of section 846 and 807	4.06%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2007. See Rev. Rul. 2007-70, page 1158.

Part III. Administrative, Procedural, and Miscellaneous

Phase-out of Credit for New Qualified Hybrid Motor Vehicles and New Advanced Lean Burn Technology Motor Vehicles

Notice 2007–98

SECTION 1. PURPOSE

This notice announces the credit phase-out schedule for new advanced lean burn technology motor vehicles and new qualified hybrid passenger automobiles and light trucks manufactured by American Honda Motor Company, Inc.

SECTION 2. BACKGROUND

Section 30B(a)(2) of the Internal Revenue Code provides for a credit determined under § 30B(c) for certain new advanced lean burn technology motor vehicles. Section 30B(a)(3) provides for a credit determined under § 30B(d) for certain new qualified hybrid motor vehicles. Both the new advanced lean burn technology motor vehicle credit and the new qualified hybrid motor vehicle credit begin to phase out for a manufacturer's passenger automobiles and light trucks in the second calendar quarter after the calendar quarter in which at least 60,000 of the manufacturer's passenger automobiles and light trucks that qualify for either credit have been sold for use or lease in the United States (determined on a cumulative basis for sales after December 31, 2005). Taxpayers purchasing the manufacturer's vehicles during the first two calendar quarters of the phase-out period may claim only 50 percent of the otherwise allowable credit. Taxpayers purchasing the manufacturer's vehicles during the third and fourth quarters of the phase-out period may claim only 25 percent of the otherwise allowable credit. No credit is available for vehicles purchased after the last day of the fourth quarter of the phase-out period.

Notice 2006–9, 2006–6 C.B. 413, provides procedures for a vehicle manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to certify to the Internal Revenue Service (Service) both (1) that a particular make, model, and model year of vehicle qualifies for either the advanced lean burn technology motor vehicle credit or the new qualified hybrid motor vehicle credit and (2) the amount of the credit allowable with respect to that vehicle.

Section 5.05 of Notice 2006–9 requires a manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) that has received from the Service an acknowledgement of its certification for a particular make, model, and model year of vehicle to submit to the Service a report of the number of qualified vehicles sold by the manufacturer (or, in the case of a foreign vehicle manufacturer, its domestic distributor) to retail dealers during the calendar quarter. A qualified vehicle is defined for this purpose as any passenger automobile or light truck that is a new advanced lean burn technology motor vehicle or a new qualified hybrid motor vehicle.

In accordance with section 5.05 of Notice 2006–9, American Honda Motor Company, Inc. has submitted quarterly reports that indicate that its cumulative sales of qualified vehicles to retail dealers reached the 60,000-vehicle limit during the calendar quarter ending September 30, 2007. Accordingly, the credit for all new advanced lean burn technology motor vehicles or new qualified hybrid passenger automobiles or light trucks manufactured by American Honda Motor Company, Inc. will begin to phase out on January 1, 2008.

SECTION 3. SCOPE OF NOTICE

This notice applies to any make, model, or model year of new advanced lean burn technology motor vehicle or new qualified hybrid passenger automobile or light truck that is—

(1) manufactured by American Honda Motor Company, Inc.; and

(2) purchased for use or lease in the United States on or after January 1, 2008.

SECTION 4. CREDIT AMOUNT

.01 *In general.* If a new advanced lean burn technology motor vehicle or new qualified hybrid passenger automobile or light truck manufactured by American Honda Motor Company, Inc. is purchased for use or lease after December 31, 2007, the allowable credit is as follows:

(1) For vehicles purchased for use or lease on or after January 1, 2008, and on or before June 30, 2008, the credit is 50 percent of the otherwise allowable amount determined under § 30B(c) or (d) (whichever is applicable);

(2) For vehicles purchased for use or lease on or after July 1, 2008, and on or before December 31, 2008, the credit is 25 percent of the otherwise allowable amount determined under § 30B(c) or (d) (whichever is applicable); and

(3) For vehicles purchased for use or lease on or after January 1, 2009, no credit is allowable.

.02 Certified Vehicles. The following tables set forth the credit available on or after January 1, 2008, for hybrid motor vehicles for which American Honda Motor Company, Inc. received an acknowledgement of its certification from the Service on or before November 19, 2007:

Table 1

January 1, 2008 — June 30, 2008		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$325
2005	Accord Hybrid Navi AT	$325
2005	Civic Hybrid MT	$850
2005	Civic Hybrid CVT	$850
2005	Insight CVT	$725
2006	Accord Hybrid AT with updated calibration	$650
2006	Accord Hybrid Navi AT with updated calibration	$650
2006	Accord Hybrid AT without updated calibration	$325
2006	Accord Hybrid Navi AT without updated calibration	$325
2006	Civic Hybrid CVT	$1050
2006	Insight CVT	$725
2007	Accord Hybrid AT	$650
2007	Accord Hybrid Navi AT	$650
2007	Civic Hybrid CVT	$1050
2008	Civic Hybrid CVT	$1050

Table 2

July 1, 2008 — December 31, 2008		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$162.50
2005	Accord Hybrid Navi AT	$162.50
2005	Civic Hybrid MT	$425
2005	Civic Hybrid CVT	$425
2005	Insight CVT	$362.50
2006	Accord Hybrid AT with updated calibration	$325
2006	Accord Hybrid Navi AT with updated calibration	$325
2006	Accord Hybrid AT without updated calibration	$162.50
2006	Accord Hybrid Navi AT without updated calibration	$162.50

Model Year	Model	Credit Amount
2006	Civic Hybrid CVT	$525
2006	Insight CVT	$362.50
2007	Accord Hybrid AT	$325
2007	Accord Hybrid Navi AT	$325
2007	Civic Hybrid CVT	$525
2008	Civic Hybrid CVT	$525

Table 3

On or After January 1, 2009		
Model Year	**Model**	**Credit Amount**
2005	Accord Hybrid AT	$0.00
2005	Accord Hybrid Navi AT	$0.00
2005	Civic Hybrid MT	$0.00
2005	Civic Hybrid CVT	$0.00
2005	Insight CVT	$0.00
2006	Accord Hybrid AT with updated calibration	$0.00
2006	Accord Hybrid Navi AT with updated calibration	$0.00
2006	Accord Hybrid AT without updated calibration	$0.00
2006	Accord Hybrid Navi AT without updated calibration	$0.00
2006	Civic Hybrid CVT	$0.00
2006	Insight CVT	$0.00
2007	Accord Hybrid AT	$0.00
2007	Accord Hybrid Navi AT	$0.00
2007	Civic Hybrid CVT	$0.00
2008	Civic Hybrid CVT	$0.00

The principal author of this notice is Nicole R. Cimino of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Ms. Cimino at (202) 622–3110 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 62, 162, 170, 213, 217, 274, 1016; 1.62–2, 1.162–17, 1.170A–1, 1.213–1, 1.217–2, 1.274–5, 1.1016–3.)

Rev. Proc. 2007–70

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2006–49, 2006–47 I.R.B. 936, and provides optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee are deemed substantiated under § 1.274–5 of the Income Tax Regulations if a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance ar-

rangement to pay for the expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. The Internal Revenue Service prospectively adjusts the business and medical and moving standard mileage rates annually (to the extent warranted).

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

.01 *Standard mileage rates*

(1) Business (section 5 below)	50.5 cents per mile
(2) Charitable contribution (section 7 below)	14 cents per mile
(3) Medical and moving (section 7 below)	19 cents per mile

.02 *Determination of standard mileage rates*. The business and medical and moving standard mileage rates reflected in this revenue procedure are based on an annual study of the fixed and variable costs of operating an automobile conducted on behalf of the Service by an independent contractor. The charitable contribution standard mileage rate is provided in § 170(i) of the Internal Revenue Code.

SECTION 3. BACKGROUND AND CHANGES

.01 Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction is allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. Section 274(d) further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by the regulations.

.03 Section 1.274–5(j), in part, grants the Commissioner of Internal Revenue the authority to establish a method under which a taxpayer may use mileage rates to substantiate, for purposes of § 274(d), the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which the allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of the travel and transportation expenses for purposes of § 1.274–5(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of the expenses for purposes of § 1.274–5(f).

.05 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein do not apply to any expense to the extent that, under the grant of regulatory authority in § 274(d), the Commissioner has provided that substantiation is not required for the expense.

.07 Under § 1.62–2(c), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan and are excluded from income and wages. If an arrangement does not meet these requirements, all amounts paid under the arrangement are treated as paid under a nonaccountable plan and are included in the employee's gross income, must be reported as wages or compensation on the employee's Form W–2, and are subject to the withholding and payment of employment taxes. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) will be treated as substantiation of the amount of the expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances is treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of the allowance that relates to miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not

to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of the allowance that relates to miles of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g), and that the employee is not required to return, is subject to withholding and payment of employment taxes. *See* §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner may provide special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

.10 Sections 9.09 and 10.03 of this revenue procedure refer to Rev. Rul. 2006–56, 2006–46 I.R.B. 874, which describes circumstances when a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder.

SECTION 4. DEFINITIONS

.01 *Standard mileage rate.* The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) they own or lease for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses.* The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance.* The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that is:

(1) paid with respect to the ordinary and necessary business expenses incurred, or that the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule.* A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. The allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the variable costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for those purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general.* The standard mileage rate for transportation expenses is 50.5 cents per mile for all miles of use for business purposes.

.02 *Use of the business standard mileage rate.* A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both fixed and variable) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of fixed and variable costs.* A deduction using the business standard mileage rate is computed on a yearly basis and is in lieu of all fixed and variable costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Items such as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in fixed and variable costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local personal property taxes may be deducted as separate items, but only to the extent allowable under § 163 or § 164, respectively. Section 163(h)(2)(A) expressly provides that interest is nondeductible personal interest if it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property are treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of the property. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable.

.05 *Depreciation.* For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation is considered to have been allowed at the rate of 16 cents per mile for 2003 and 2004, 17 cents per mile

for 2005 and 2006, 19 cents per mile for 2007, and 21 cents per mile for 2008 for those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, these rates do not apply to any year in which actual costs were used. The depreciation described above reduces the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations*.

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) five or more automobiles owned or leased by a taxpayer and used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible business expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a fixed and variable rate allowance (FAVR allowance) (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, (c) claimed the special depreciation allowance under § 168(k), or (d) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for the expenses. *See* § 162(o) for the rules that apply to these qualified reimbursements.

SECTION 6. RESERVED

SECTION 7. CHARITABLE AND MEDICAL AND MOVING STANDARD MILEAGE RATES

.01 *Charitable*. Section 170(i) provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable contribution deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170.

.02 *Medical and moving*. The standard mileage rate is 19 cents per mile for use of an automobile (1) to obtain medical care described in § 213, or (2) as part of a move for which the expenses are deductible under § 217.

.03 *Charitable or medical and moving standard mileage rates in lieu of variable expenses*. A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all variable expenses (including gasoline and oil) of the automobile allocable to those purposes. Costs for items such as depreciation (or lease payments), insurance, and license and registration fees are not deductible, and are not included in the charitable or medical and moving standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items. Interest relating to the purchase of the automobile and state and local personal property taxes are not deductible as charitable, medical, or moving expenses, but they may be deducted as separate items to the extent allowable under § 163 or § 164, respectively.

SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general*.

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer are deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses those expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Computation of FAVR allowance*.

(1) *FAVR allowance*. A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes when paid. *See* section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment*. A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license

fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment.* A periodic variable payment covers the projected variable costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected variable costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality.* A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of variable costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile.* A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost.* The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of the automobile. Further, the standard automobile cost may not exceed $27,500.

(7) *Annual mileage.* Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage.* Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage.* A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	*Business use percentage*
6,250 or more but less than 10,000	45 percent
10,000 or more but less than 15,000	55 percent
15,000 or more but less than 20,000	65 percent
20,000 or more	75 percent

(10) *Retention period.* A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. The period may not be less than two calendar years.

(11) *Retention mileage.* Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value.* The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	*Residual value*
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of fixed and variable costs.*

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the fixed and variable costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Items such as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in fixed and variable costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and variable costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, (c) claimed the special depreciation allowance under § 168(k), or (d) used ACRS under former § 168 or MACRS under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) Except as provided in section 8.04(3) of this revenue procedure, the total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of the depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) If the depreciation component of periodic fixed payments exceeds the limitations in section 8.04(2) of this revenue procedure, that section will be treated as satisfied in any year during which the total annual amount of the periodic fixed payments and the periodic variable payments made to an employee driving 80 percent of the annual business mileage of the standard automobile does not exceed the amount obtained by multiplying 80 percent of the annual business mileage of the standard automobile by the business standard mileage rate for that year (under section 5.01 of the applicable revenue procedure).

(4) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile reduces the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. *See* section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) An employer may not pay a FAVR allowance if at any time during a calendar year a majority of the employees covered by the FAVR allowance are management employees.

(4) An employer may not pay a FAVR allowance to any employee unless at all times during a calendar year at least five employees in total are covered by FAVR allowances provided by the employer.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, as a new vehicle (whether or not purchased new by the employee), was at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account rate-increasing factors such as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at

least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.* Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if coverage has lapsed, the employee by written declaration must provide the payor with the following information: (1) the make, model, and year of the employee's automobile, (2) written proof of the insurance coverage limits on the automobile, (3) the odometer reading of the automobile, (4) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (5) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (1), (2), and (3) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting.*

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from the Modified Accelerated Cost Recovery System pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements.* If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of the failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home) and (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation) of § 1.274–5T, and paragraph (c) of § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). *See also* § 1.62–2(e)(1) for the rule that, in order to satisfy the substantiation requirement of an accountable plan, an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance (other than a FAVR allowance) paid only at a cents-per-mile rate, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of the allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of the allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $109.00 based on an anticipated 200 business miles at 54.5 cents per mile (at a time when the business standard mileage rate is 50.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts is treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($43.60) even though the employee is not required to return the portion of the allowance ($4.80) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($60.60) for the 120 substantiated business miles. However, the $4.80 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a mileage allowance (other than a FAVR allowance) paid other than only

at a cents-per-mile rate, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of the allowance that exceeds the product of the standard mileage rate and the number of miles of travel substantiated by the employee. For example, assume a payor provides an employee an advance mileage allowance of $400 per month plus 20 cents per mile based on an anticipated 2000 miles for a total of $800 (at a time when the business standard mileage rate is 50.5 cents per mile), and the employee substantiates 1000 business miles. The requirement to return excess amounts is treated as satisfied if the employee is required to return $295, the portion of the allowance that exceeds the product of the standard mileage rate and the miles substantiated ($505).

(3) For a FAVR allowance, the requirement to return excess amounts is treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. *See* § 1.274–5T(f)(2)(i). Assuming that the remaining requirements for an accountable plan provided in § 1.62–2 are satisfied, that portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W–2, and is exempt from withholding and payment of employment taxes. *See* § 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02 of this revenue procedure. *See* § 1.274–5T(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06 If an employee's substantiated expenses are less than the employee's actual expenses, the following rules apply:

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses (not just the excess over the business standard mileage rate), includes on Form 2106, *Employee Business Expenses*, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. *See* § 1.274–5T(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses under section 9.06(1) unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. *See* § 1.62–2(k) and Rev. Rul. 2006–56. Thus, the payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3), (c)(5), and (h)(2), and section 10.03 of this revenue procedure.

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is treated as paid under a nonaccountable plan and is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. *See* § 1.62–2(h)(2)(i)(B)(2).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of em-

ployment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. *See* § 1.62–2(h)(2)(i)(B)(3). If some or all of the business miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (for example, a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. *See* § 1.62–2(h)(2)(i)(B)(4).

(4) For example, assume an employer pays its employees a mileage allowance under an arrangement that otherwise meets the requirements of an accountable plan at a rate of 54.5 cents per mile (when the business standard mileage rate is 50.5 cents per mile). The employer does not require the return of the portion of the allowance that exceeds the business standard mileage rate for the business miles substantiated (4.0 cents). In June, the employer advances an employee $272.50 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $54.50 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $202.00 and the employee is not required to return $16.00. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must withhold and pay employment taxes on $16.00.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

.03 If a mileage allowance arrangement has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and the arrangement routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all the expenses or repayment of the excess amount, the failure of the arrangement to treat the excess allowances as wages for employment tax purposes causes all payments made under the arrangement to be treated as made under a nonaccountable plan. *See* Rev. Rul. 2006–56.

SECTION 11. EFFECTIVE DATE

This revenue procedure is effective for (1) deductible transportation expenses paid or incurred on or after January 1, 2008, and (2) mileage allowances or reimbursements paid to an employee or to a charitable volunteer (a) on or after January 1, 2008, and (b) with respect to transportation expenses paid or incurred by the employee or charitable volunteer on or after January 1, 2008.

SECTION 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2006–49 is superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Bernard P. Harvey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Harvey at (202) 622–4930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Modifications of Commercial Mortgage Loans Held by a Real Estate Mortgage Investment Conduit (REMIC)

REG–127770–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would expand the list of permitted loan modifications to include certain modifications of commercial mortgages. Changes to the regulations are necessary to better accommodate evolving commercial mortgage industry practices. These changes will affect lenders, borrowers, servicers, and sponsors of securitizations of mortgages in REMICs.

DATES: Written or electronic comments and requests for a public hearing must be received by February 7, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–127770–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–127770–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–127770–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Diana Imholtz or Susan Thompson Baker, (202) 622–3930; concerning submissions of comments and requests for a public hearing, Kelly D. Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 8, 2008.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.860G–2(b)(7). This information is required in order to show that modifications to mortgages permitted by the proposed regulation will not cause the modified mortgage to cease to be a qualified mortgage. The collection of information is voluntary to obtain a benefit. The likely respondents are businesses or other for-profit institutions.

Estimated total annual reporting burden: 3000 hours.

Estimated average annual burden hours per respondent: 8.

Estimated annual frequency of responses: 1.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to 26 CFR part 1 under section 860G of the Internal Revenue Code (Code). The REMIC provisions under sections 860A through 860G provide for a pass-through vehicle that issues multiple classes of interests in pools of residential and commercial mortgage loans. All income from the mortgage loans in the REMIC is taxed to the holders of the regular and residual interests in the REMIC. Among the requirements for qualification are that the mortgage loans held by the REMIC must consist of "qualified mortgages" that are principally secured by an interest in real property. All loans must be acquired on the startup day of the REMIC or within three months thereafter, except that the REMIC may exchange a defective loan for a "qualified replacement mortgage" for up to two years.

Section 1.860G–2(b)(1) of the Income tax regulations (the regulations) provides that, subject to certain exceptions described in §1.860G–2(b)(3), if an obligation is significantly modified, then the modified obligation is treated as one that was newly issued in exchange for the unmodified obligation that it replaced. If such a significant modification occurs after the obligation has been contributed to the REMIC and the modified obligation is not a qualified replacement

mortgage, the modified obligation will not be a qualified mortgage and the deemed disposition of the unmodified obligation will be a prohibited transaction under section 860F(a)(2). Section 1.860G–2(b)(2) defines a "significant modification" as any change in the terms of an obligation that would be treated as an exchange of obligations under section 1001 and the related regulations. The treatment of specific loan modifications as deemed exchanges is addressed in §1.1001–3. Section 1.1001–3 defines a loan modification and provides that a modification that is significant will be treated as a deemed exchange of the original loan for a new loan.

Section 1.860G–2(b)(3) of the regulations sets forth four types of loan modifications that are expressly permitted without regard to the section 1001 modification rules. The four permitted modifications are: (i) changes in the terms of the obligation occasioned by default or a reasonably foreseeable default; (ii) assumption of the obligation; (iii) waiver of a due-on-sale clause or a due on encumbrance clause; and (iv) conversion of an interest rate by a mortgagor pursuant to the terms of a convertible mortgage.

The present REMIC regulations were adopted in 1992 at a time when the mortgage-backed securities market involved primarily residential mortgage loans. Since that time, the securitization of commercial mortgage loans has become more common. The four types of modifications that are expressly permitted without regard to the section 1001 modification rules cover the most common changes affecting residential mortgage loans, but may not cover the range of likely changes in commercial mortgage loans.

In Notice 2007–17, 2007–12 I.R.B. 748, the IRS and Treasury Department solicited input on whether the present REMIC regulations should be amended to permit additional types of modifications incurred in connection with the commercial mortgage loans. In response to Notice 2007–17, the IRS and Treasury Department received three comments. See §601.601(d)(2)(ii)(*b*).

The first comment set forth a proposal to add six new types of permissible modifications: (1) a modification that releases, adds, substitutes or otherwise alters any portion of the collateral for, a guarantee of, or other form of credit enhancement for the obligation, whether recourse or nonrecourse (other than an alteration that causes the obligation not to be principally secured by an interest in real property); (2) a change in the obligation from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse), or vice versa; (3) a change in the date on which the obligation may be prepaid or defeased in whole or in part, or addition of a defeasance provision; (4) substitution of a new obligor or addition or deletion of a co-obligor on the obligation; (5) imposition or waiver of a prepayment penalty or other fee; and (6) a change of the principal payment schedule of a loan following a voluntary or involuntary prepayment of principal. The second comment set forth a proposal to add two new types of permissible modifications relating to changes in collateral and defeasance that are substantially similar to proposals (1) and (3) of the first comment. In addition, the second comment set forth a proposal to revise the existing exception for assumptions of the obligation to include any substitution of a guarantor for a guarantee on, or other form of credit enhancement for, an obligation. The first and second comments also set forth examples of the most common changes to commercial loans requested by commercial borrowers to assist the IRS and Treasury Department in understanding the particular business need served by each proposed modification.

Finally, the third comment requested that the IRS and Treasury Department consider a prior proposal advocating a new standard to measure materiality for modifications to loans held by a REMIC. Rather than adding specific types of loan modifications to the list of permitted modifications, the prior proposal recommended that the REMIC regulations be revised to provide that any change in the terms of a qualified mortgage will not cause it to cease to be a qualified mortgage so long as the change does not increase the principal amount or extend the maturity of the mortgage.

IRS and Treasury Department personnel, including personnel from Large & Mid-Size Business (LMSB) and LMSB Division Counsel, reviewed all comments and met with certain of the submitting parties to explore the proposals and the analysis supporting those proposals. After consideration of all comments received, the IRS and Treasury Department believe that it is appropriate at this time to propose amendments to the REMIC regulations to permit certain additional types of modifications to commercial mortgages.

Explanation of Provisions

1. *General*

The proposed regulations are intended to address the concerns raised by the commercial real estate industry that the existing REMIC regulations do not adequately accommodate legitimate business practices existing in the commercial mortgage securitization market. Submitting parties have indicated that the real property that secures a commercial mortgage loan is typically an active, income-generating, business property of the commercial loan borrower. Thus, in contrast to residential mortgage loans, there is a greater need to make ongoing changes to the terms of a commercial mortgage loan. For example, a borrower may request a release of a parcel of land from the lien of the mortgage to either sell or develop the land. Although the mortgage continues to be principally secured by an interest in real property following the release, such a change under the existing REMIC regulations might cause the mortgage to cease to be a qualified mortgage.

The legislative history indicates that REMICs "should be flexible enough to accommodate most legitimate business concerns while preserving the desired certainty of income tax treatment." S. Rep. No. 99–313, 99th Cong., 2d Sess., at 792. The legislative history also indicates that a REMIC, to preserve its tax status, must consist of a substantially fixed pool of real estate mortgages and related assets and have "no powers to vary the composition of its mortgage assets." S. Rep. No. 99–313, 99th Cong., 2d Sess., at 791–792. Accordingly, the proposed regulations are intended to strike a balance between accommodating the legitimate business concerns of the commercial real estate industry with the requirement that a REMIC remain a substantially fixed pool of mortgages and not be engaged in an active lending business.

In weighing the business needs of the industry against Congressional intent that a REMIC consist of a fixed pool of quali-

fied mortgages that are principally secured by real property and whose income can be accurately calculated as of the startup day, the IRS and Treasury Department applied four core concepts to each of the proposed modifications. First, to minimize changes to REMIC cash flows after the startup day, the IRS and Treasury Department analyzed whether a particular modification would be likely to produce any significant gain or loss to the REMIC. Second, the IRS and Treasury Department considered whether a mortgage loan, if permitted to be modified as requested by submitting parties, would remain principally secured by real property after the modification. Third, the IRS and Treasury Department examined the ability of the IRS to review and administer compliance with the requirements of a particular modification. Finally, the IRS and Treasury Department considered the business needs indicated by the industry for a borrower requesting a particular modification to the terms of the loan and whether that business need was adequately addressed by the current regulations.

2. *Proposed Modifications*

In applying the four core concepts, the IRS and Treasury Department determined that proposals relating to changes in collateral, guarantees and credit enhancement of an obligation and changes to the recourse nature of an obligation should be added to the list of permitted exceptions under section 860G to the section 1001 modification rules. These changes would be permitted so long as the obligation continues to be principally secured by an interest in real property. The proposed regulations also would clarify that a release of a lien on real property collateral securing a mortgage does not disqualify a mortgage so long as the mortgage continues to be principally secured by an interest in real property after giving effect to any releases, substitutions, additions or other alterations to the collateral.

Section 1.860G–2(a)(1) of the current regulations provides that an obligation is principally secured by an interest in real property if the fair market value of the real property that secures the obligation equals at least 80 percent of the adjusted issue price of the obligation. The current regulations require the 80-percent test to be satisfied either at the time the obligation was originated or at the time the sponsor contributes the obligation to the REMIC. To ensure that a modified mortgage loan continues to be principally secured by an interest in real property, the proposed regulations require the 80-percent test to be satisfied at the time the mortgage loan is modified as determined by an appraisal performed by an independent appraiser.

To support their proposals, commentators provided examples of loan modification requests that arise with some frequency in commercial mortgage loan securitizations. The majority of those examples involved requests to change the security or credit enhancement of an obligation. Accordingly, the IRS and Treasury Department expect that, by permitting changes to collateral and changes to the recourse nature of an obligation without regard to the section 1001 modification rules, the proposed regulations will resolve many of the industry's business concerns arising from borrower requests to modify commercial mortgage loans.

3. *Other Modifications*

In balancing the competing interests noted in the preceding discussion, however, the IRS and Treasury Department determined that the remainder of the changes requested by commentators to accommodate business needs of the industry could not be adopted in the proposed regulations. First, commentators set forth a proposal to permit changes to the date on which a commercial mortgage loan may be defeased and to permit the addition of a defeasance provision where the original terms of the mortgage loan do not otherwise provide. By defeasing a commercial mortgage loan, the borrower replaces the underlying real property collateral securing the mortgage with government securities whose payments match the mortgage's payments. Section 1.860G–2(a)(8) of the current regulations permits defeasance of a mortgage loan, under certain conditions, including the condition that the defeasance not occur within 2 years of the startup date of the REMIC. These conditions are intended to ensure that the defeasance transaction is undertaken as part of a customary commercial transaction and not as part of an arrangement to collateralize a REMIC with obligations that are not real estate mortgages.

Commentators indicated that while defeasance is currently the preferred means by which a borrower can obtain an early release from liability on a commercial mortgage, the original terms of commercial loan documents do not always satisfy the current defeasance exception. Submitting parties maintain that expanding the borrower's ability to defease does not violate the policy against replacing real property securing a commercial mortgage with other collateral so long as the defeasance does not occur within two years of the startup date. The IRS and Treasury Department believe, however, that the current defeasance exception already adequately accommodates the legitimate business need of providing borrowers with the ability to defease a mortgage loan if certain conditions are met. Expanding the defeasance exception is not warranted given Congress' intent that REMICs consist of a substantially fixed pool of real estate mortgages and related assets.

Second, commentators set forth a proposal to expand the existing exception for assumptions of the obligation such that any changes to the obligor on a commercial mortgage loan, including the addition or deletion of a co-obligor, would be permitted. In general, a change to the obligor on a nonrecourse debt instrument is not a significant modification for purposes of the section 1001 modification rules. The submitting parties indicated that the vast majority of commercial mortgage loans are nonrecourse. As a result, permitting a borrower to make changes to the obligor on a commercial mortgage would not generally cause the mortgage to cease to be a qualified mortgage. For this reason, the IRS and Treasury Department do not believe that expanding the existing exception for assumptions of the obligation is necessary to address a business need of the industry that was not already addressed by the current regulations.

Third, the commentators set forth a proposal to allow for the imposition or waiver of a prepayment penalty. The imposition or waiver of a prepayment penalty generally results in a change in yield on an obligation and can further result in a significant modification under §1.1001–3(e)(2) of the regulations if the annual yield of the modified obligation

varies from the unmodified obligation by more than the greater of 25 basis points or 5 percent of the yield of the unmodified instrument. Commentators indicated that although there is an administrative burden imposed on the servicer because the yield change computations are complicated and are performed frequently due to borrower requests, the change in yield resulting from an imposition or waiver of a prepayment penalty does not generally cause a significant modification and does not cause the mortgage to cease to be a qualified mortgage. Accordingly, the IRS and Treasury Department do not believe that adoption of this proposal is necessary to address a business need of the industry that was not already addressed by the current regulations.

Fourth, commentators set forth a proposal to permit changes in the principal payment schedule following a partial prepayment of a mortgage. Commentators indicated that loan documents do not always provide for a reamortization or other adjustment of a principal payment schedule after a partial principal payment on a loan. In general, a material deferral of scheduled principal payments is a significant modification under the section 1001 modification rules. Section 1.1001–3(e)(3)(ii) of the regulations, however, provides a safe harbor period that begins on the original due date of the first deferred payment and extends for a period equal to the lesser of 5 years or 50 percent of the original term of the obligation. In addition, a *pro rata* prepayment of all of the remaining payments on an obligation does not result in a modification of the portion of the obligation that remains outstanding.

In light of the safe harbor and the rule for *pro rata* prepayments, it is not clear to the IRS and Treasury Department whether permitting changes to the timing of principal payments is necessary. In addition, it is not clear whether a change in the principal payment schedule of a commercial mortgage loan could result in a change in yield more than the greater of 25 basis points or 5 percent of the yield of the unmodified loan.

Finally, one commentator advocated a new standard to measure materiality for modifications to loans held by a REMIC that departs from the standards set forth under section 1001. The IRS and Treasury Department continue to believe that the section 1001 standard should generally govern modifications of mortgage loans held by a REMIC. The IRS and Treasury Department further believe that adding to the list of exceptions expressly permitted without regard to the section 1001 modifications strikes the appropriate balance between accommodating the business needs of the industry with the requirement that a REMIC remain a substantially fixed pool of mortgages.

4. *Interaction with Section 1001*

The additional types of modifications permitted by the proposed regulations will exempt the modified obligation from deemed exchange treatment for purposes of §1.860G–2(b)(1) of the regulations only. For example, a commercial mortgage loan that is modified from nonrecourse to recourse and continues to be principally secured by an interest in real property will continue to be a qualified mortgage and will not be subject to the prohibited transaction tax under section 860F(a)(2). Such a modification, however, is significant under §1.1001–3 and will be treated as a deemed exchange of the original mortgage loan for a new mortgage loan for purposes of section 1001. Accordingly, any resulting gain or loss under section 1001 must be included in the computation of the REMIC's taxable income.

Effective Date

These regulations are proposed to apply to modifications made to the terms of an obligation on or after publication of this document in the Federal Register as a Treasury decision.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation.

It is hereby certified that the collection of information requirement in this regulation will not have a significant economic impact on a substantial number of small business entities. This certification is based on the fact that the REMICs affected by this regulation will not be classified as small business entities. According to the Small Business Administration definition of a "small business," 13 C.F.R. 121.201, a REMIC is classified under Sector 52 (Finance and Insurance), Subsector 525 (Funds, Trusts and Other Financial Vehicles) under the category "Other Financial Vehicle", NAICS code 525990, and is only considered a small business entity if it accumulates less than 6.5 million dollars in annual receipts. REMICs affected by this regulation generally hold pools of commercial mortgage loans with an average loan size of 18.1 million dollars, and have greater than 6.5 million dollars in annual receipts. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). Other personnel from the IRS and Treasury Department participated, however, in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.860A–0 also issued under 26 U.S.C. 860G(e).

Section 1.860A–1 also issued under 26 U.S.C. 860G(e).

Section 1.860G–2 also issued under 26 U.S.C. 860G(e). * * *

Par. 2. Section 1.860A–0 is amended by adding an entry for §1.860G–2(b)(7) to read as follows:

§1.860A–0 Outline of REMIC provisions.

* * * * *

§1.860G–2 Other rules.

* * * * *

(b) * * *

(7) Principally secured test; appraisal requirement.

* * * * *

Par. 3. Section 1.860A–1 is amended by adding paragraph (b)(6) to read as follows:

§1.860A–1 Effective dates and transition rules.

* * * * *

(b) * * *

(6) *Exceptions for certain modified obligations.* Paragraphs (b)(3)(v), (b)(3)(vi) and (b)(7) of §1.860G–2 apply to modifications made to the terms of an obligation on or after the date of publication of this document in the Federal register as a Treasury decision.* * * * *

Par. 4. Section 1.860G–2 is amended by:

1. Revising paragraphs (a)(8), (b)(3)(iii) and (b)(3)(iv).

2. Adding paragraphs (b)(3)(v), (b)(3)(vi) and (b)(7).

The additions and revisions read as follows:

§1.860G–2 Other rules.

(a) * * *

(8) *Release of interest in real property securing a qualified mortgage; defeasance.* If a REMIC releases its lien on real property that secures a qualified mortgage, that mortgage ceases to be a qualified mortgage on the date the lien is released unless —

(i) The REMIC releases its lien pursuant to a modification described in paragraph (b)(3)(v) of this section addressing changes to the collateral for, guarantees on, or other form of credit enhancement on a mortgage; or

(ii) The mortgage is defeased in the following manner —

(A) The mortgagor pledges substitute collateral that consists solely of government securities (as defined in section 2(a)(16) of the Investment Company Act of 1940 as amended (*15 U.S.C. 80a–1*));

(B) The mortgage documents allow such a substitution;

(C) The lien is released to facilitate the disposition of the property or any other customary commercial transaction, and not as part of an arrangement to collateralize a REMIC offering with obligations that are not real estate mortgages; and

(D) The release is not within 2 years of the startup day.

* * * * *

(b) * * *

(3) * * *

(iii) Waiver of a due-on-sale clause or a due on encumbrance clause;

(iv) Conversion of an interest rate by a mortgagor pursuant to the terms of a convertible mortgage;

(v) A modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a recourse or nonrecourse obligation, so long as the obligation continues to be principally secured by an interest in real property following such release, substitution, addition or other alteration; and

(vi) A change in the nature of the obligation from recourse (or substantially all recourse) to nonrecourse (or substantially all nonrecourse), so long as the obligation continues to be principally secured by an interest in real property following such a change.

* * * * *

(7) *Principally secured test; appraisal requirement.* For purposes of paragraph (b)(3)(v) and (vi) of this section, in determining whether an obligation continues to be principally secured by an interest in real property, the fair market value of the interest in real property securing the obligation, determined as of the date of the modification, must be equal to at least 80 percent of the adjusted issue price of the modified obligation, determined as of the date of the modification. For purposes of this test, the fair market value of the interest in real property securing the obligation must be determined by an appraisal performed by an independent appraiser.

* * * * *

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 8, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 9, 2007, 72 F.R. 63523)

Wind Energy Partnerships

Announcement 2007–112

This announcement revises Revenue Procedure 2007–65, 2007–45 I.R.B. 967, by adding the following language to Section 3: "The requirements set forth in this revenue procedure that must be satisfied in order to qualify for the Safe Harbor, however, are not intended to provide substantive rules and are not to be used as audit guidelines," and replacing "will not challenge" with "will respect" in Section 6.

The principal authors of this announcement are Vishal R. Amin and Richard T. Probst of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this announcement, contact Vishal R. Amin or Richard T. Probst at (202) 622–3060 (not a toll-free call).

Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information

Announcement 2007–114

This announcement alerts the public to the fact that a new proposed form, Form 8926, *Disqualified Corporate Interest Expense Disallowed Under Section 163(j) and Related Information*, is being posted on the IRS website. The proposed form requires corporate taxpayers that either paid or accrued any disqualified interest for the taxable year or carried forward disallowed disqualified interest from prior taxable years under section 163(j) of the Internal Revenue Code to provide certain information relating to the determinations and computations under section 163(j).

Section 163(j) imposes a limitation on deductions for interest paid or accrued by corporations to related persons where the interest is exempt or partially exempt from taxation. Section 163(j) also applies to a corporation that pays or accrues interest to an unrelated party if the interest is not subject to a gross basis tax and the guarantor is a related person who is either a foreign person or a tax-exempt organization as well as to a taxable REIT subsidiary of a REIT that pays or accrues interest to the REIT.

Section 424 of the American Jobs Creation Act of 2004, Public Law 108–357, 118 Stat. 1418 (October 22, 2004), mandated that the Secretary of the Treasury or a delegate conduct a study of the effectiveness of provisions of the Internal Revenue Code of 1986 applicable to earnings stripping.

The Treasury Department has conducted a study of earnings stripping as directed by Congress and has issued a report regarding its findings and recommendations on this issue. The study recommends that the relevant tax forms be modified to require more information about earnings stripping. Therefore, proposed Form 8926 has been created to obtain information relating to the application of section 163(j).

Proposed Form 8926 solicits information relating to the determination and computation of a corporate taxpayer's section 163(j) limitation, including the determination of the taxpayer's debt-to-equity ratio, net interest expense, adjusted taxable income, excess interest expense, total disqualified interest for the tax year and the amount of interest deduction disallowed under section 163(j), as well as certain information with respect to the related persons receiving disqualified interest. The proposed form will be posted on the IRS website at *www.irs.gov/taxpros/topic/index.html* under Draft Tax Forms.

The principal author of this announcement is Sheila Ramaswamy of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this announcement, contact Sheila Ramaswamy at (202) 622–3870 (not a toll-free call).

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)–3: Exclusion for contributions to purchase section 403(b) contracts.

Whether there are model amendments for public schools that address the provisions of section 1.403(b) of the Income Tax Regulations. See Rev. Proc. 2007-71, page 1184.

Section 6039.—Returns Required in Connection With Certain Options

26 CFR 1.6039–1T: Reporting of certain employer-owned life insurance contracts (temporary).

T.D. 9364

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Information Reporting on Employer-Owned Life Insurance Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations concerning information reporting on employer-owned life insurance contracts under section 6039I of the Internal Revenue Code (Code). This temporary regulation is necessary to provide taxpayers with immediate guidance as to how the requirements of section 6039I should be applied. The temporary regulations generally apply to taxpayers that are engaged in a trade or business and that are directly or indirectly a beneficiary of a life insurance contract covering the life of an insured who is an employee of the trade or business on the date the contract is issued. The text of these temporary regulations also serves as the text of proposed regulations (REG–115910–07) set forth in the notice of proposed rulemaking on this subject elsewhere in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on November 13, 2007.

Applicability Date: For date of applicability, see §1.6039I–1T(b).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Linda K. Boyd, 202–622–3970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

The Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780 (2006), added sections 101(j) and 6039I to the Internal Revenue Code (Code) concerning employer-owned life insurance contracts.

Section 101(j)(1) provides that, in the case of an employer-owned life insurance contract, the amount of death benefits excluded from gross income under section 101(a)(1) shall not exceed an amount equal to the sum of the premiums and other amounts paid by the policyholder for the contract. For this purpose, an employer-owned life insurance contract is a life insurance contract that (i) is owned by a person engaged in a trade or business and under which such person is directly or indirectly a beneficiary under the contract, and (ii) covers the life of an insured who is an employee with respect to the trade or business on the date the contract is issued. An applicable policyholder is generally a person who owns an employer-owned life insurance contract, or a related person as described in section 101(j)(3).

Section 101(j)(2) provides exceptions to the general rule of section 101(j)(1) in the case of certain employer-owned life insurance contracts with respect to which certain notice and consent requirements are met. Those exceptions are based either on (i) the insured's status as an employee within 12 months of death or as a highly compensated employee or highly compensated individual, or (ii) the extent to which death benefits are paid to a family member, trust, or estate of the insured employee, or are used to purchase an equity interest in the applicable policyholder from a family member, trust or estate.

Section 6039I provides that every applicable policyholder that owns one or more employer-owned life insurance contracts shall file a return, at such time and in such manner as the Secretary shall prescribe by regulations, showing for each year the contracts are owned—

(1) The number of employees of the applicable policyholder at the end of the year;

(2) The number of such employees insured under such contracts at the end of the year;

(3) The total amount of insurance in force at the end of the year under such contracts;

(4) The name, address, and taxpayer identification number of the applicable policyholder and the type of business in which the policyholder is engaged; and

(5) That the policyholder has a valid consent for each insured employee (or, if not all such consents are obtained, the number of insured employees for whom such consent was not obtained).

Section 6039I(c) provides that any term used in section 6039I that is used in section 101(j) has the same meaning given that term by section 101(j).

Sections 101(j) and 6039I apply to life insurance contracts issued after August 17, 2006, except for a contract issued after that date pursuant to a section 1035 exchange for a contract issued before that date. For this purpose, a material increase in the death benefit or other material change causes the contract to be treated as a new contract except that, in the case of a master contract within the meaning of section 264(f)(4)(E), the addition of covered lives is treated as a new contract only with respect to those additional covered lives.

These temporary regulations provide that the Commissioner may prescribe the form and manner of satisfying the reporting requirements imposed by section 6039I on applicable policyholders owning one or more employer-owned life insurance contracts issued after August 17, 2006. The regulations are effective on November 13, 2007, and apply to taxable years ending after that date.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation.

The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to this temporary regulation because the regulation does not impose a collection of information on small entities. Even though a substantial number of small businesses may be subject to the requirements of section 6039I, it is anticipated that whatever requirements the Commissioner may prescribe pursuant to this regulation will not impose a "significant economic impact" because the information requested will already be available to taxpayers and the burden of compliance will be minimal.

Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Linda K. Boyd, Office of Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6039I–1T also issued under 26 U.S.C. 6039I. * * *

Par. 2. Section 1.6039I–1T is added to read as follows:

§1.6039I–1T Reporting of certain employer-owned life insurance contracts (temporary).

(a) *In general.* The Commissioner may prescribe the form and manner of satisfying the reporting requirements imposed by section 6039I on applicable policyholders owning one or more employer-owned life insurance contracts issued after August 17, 2006.

(b) *Effective/applicability date.* These regulations are applicable for tax years ending after November 13, 2007.

(c) *Expiration date.* The applicability of this section expires on or before November 9, 2010.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved November 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register for November 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 13, 2007, 72 F.R. 63806)

Part III. Administrative, Procedural, and Miscellaneous

2007 Cumulative List of Changes in Plan Qualification Requirements

Notice 2007–94

I. PURPOSE

This notice contains the 2007 Cumulative List of Changes in Plan Qualification Requirements (2007 Cumulative List) described in section 4 of Rev. Proc. 2007–44, 2007–28 I.R.B. 54. The 2007 Cumulative List is to be used primarily by plan sponsors of individually designed plans that are in Cycle C. An individually designed plan is in Cycle C if it is a single employer plan where the last digit of the employer identification number of the plan sponsor is 3 or 8, or it is a § 414(d) governmental plan (including a governmental multiemployer plan or governmental multiple employer plan).

The list of changes in section V of this notice does not extend the deadline by which a plan must be amended to comply with any statutory, regulatory, or guidance changes. The general deadline for timely adoption of an interim or discretionary amendment can be found in section 5.05 of Rev. Proc. 2007–44.

II. BACKGROUND

Rev. Proc. 2007–44 sets forth procedures for issuing opinion, advisory, and determination letters and describes the five-year remedial amendment cycle for individually designed plans and the six-year remedial amendment cycle for pre-approved plans. In addition, section 5.05 of Rev. Proc. 2007–44 provides the deadline for timely adoption of an interim amendment or discretionary amendment

Under section 4 of Rev. Proc. 2007–44, the Internal Revenue Service intends to annually publish a Cumulative List to identify statutory, regulatory and guidance changes that must be taken into account in submissions by plan sponsors to the Service for opinion, advisory and determination letters whose remedial amendment period begins on February 1st following issuance of the Cumulative List.

In Notice 2007–3, 2007–2 I.R.B. 255, the Service published the 2006 Cumulative List of Changes in Plan Qualification Requirements (2006 Cumulative List). In Notice 2005–101, 2005–2 C.B. 1219, the Service published the 2005 Cumulative List of Changes in Plan Qualification Requirements (2005 Cumulative List). In Notice 2004–84, 2004–2 C.B. 1030, the Service published the 2004 Cumulative List of Changes in Plan Qualification Requirements (2004 Cumulative List).

III. APPLICATION OF 2007 CUMULATIVE LIST

This notice is being issued for purposes of the determination letter program for plans submitted for determination letters during the Cycle C submission period. In Rev. Proc. 2005–66, the Service announced the opening of the initial five-year remedial amendment cycle. In accordance with Rev. Proc. 2007–44, the Service will start accepting determination letter applications for Cycle C plans beginning on February 1, 2008. The 12-month submission period for Cycle C plans will end January 31, 2009.

The 2007 Cumulative List, set forth in section V of this notice, informs plan sponsors of issues the Service has specifically identified for review in determining whether a plan filing in Cycle C has been properly updated. Specifically, the 2007 Cumulative List reflects law changes under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107–16 (with technical corrections made by the Job Creation and Worker Assistance Act of 2002 (JCWAA), Pub. L. 104–147, the Pension Funding Equity Act of 2004 (PFEA), Pub. L. 108–218, the American Jobs Creation Act of 2004 (AJCA), Pub. L. 108–357, the Gulf Opportunity Zone Act of 2005 (GOZA), Pub. L. 109–135, and the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, Pub. L. 110–28.

The Service will not consider in its review of any determination letter application, for the submission period that begins February 1, 2008, any:

(1) guidance published after October 1, 2007;

(2) statutes enacted after October 1, 2007;

(3) qualification requirements first effective in 2009 or later; or

(4) statutory provisions that are first effective in 2008, for which there is no guidance identified in this notice.

The 2007 Cumulative List does not include any items described in (1) through (4) above. However, in order to be qualified, a plan must comply with all relevant qualification requirements, not just those on the 2007 Cumulative List.

Terminating plans must include all law changes in effect at the time of termination. See section 8 of Rev. Proc. 2007–44 regarding plan termination.

IV. SPECIAL RULES FOR THE PENSION PROTECTION ACT OF 2006

Under section 1107 of the Pension Protection Act of 2006 (PPA '06), Pub. L. 109–280, a plan amendment made pursuant to any amendment made by PPA '06 generally may be retroactively effective, if, in addition to meeting the other applicable requirements, the amendment is made on or before the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011 in the case of a governmental plan). Section VI of this notice includes certain PPA '06 law changes effective in 2008 or earlier.

Plans submitting in Cycle C can be amended, at the option of plan sponsors, to include the applicable PPA '06 provisions listed in section VI of this notice. Cycle C plans must identify which PPA '06 provisions the plan has been amended to include and the plan provision that reflects the PPA '06 provision when submitting the determination letter application. However, the Service will not consider PPA '06 in issuing determination letters for Cycle C plans, and such letters cannot be relied on with respect to any plan provision identified as reflecting PPA '06, regardless of whether the plan has been amended to reflect PPA '06 provisions.

Terminating plans must include the applicable PPA '06 provisions that are in effect at the time of termination.

V. 2007 CUMULATIVE LIST OF CHANGES IN PLAN QUALIFICATION REQUIREMENTS

The following list consists of statutory provisions and associated guidance which reflect changes to plan qualification requirements. Miscellaneous guidance is also provided. The Service has identified below plan qualification requirements which were not on the 2006 Cumulative List as "(New)". Thus, the 2007 Cumulative List contains those plan qualification requirements listed in the 2004, 2005, and 2006 Cumulative Lists as well as additional 2007 plan qualification requirements.

1. *72(p)*: Section 1.72(p)–1 of the Income Tax Regulations relating to plan loans was published on December 3, 2002 (67 Fed. Reg. 71821). (2004 C. L.).

2. *401(a)*: Final Regulations under § 401(a) of the Code regarding permissible normal retirement ages were published May 22, 2007 (72 Fed. Reg. 28604). (2006 C. L.).

    - Notice 2007–69, 2007–35 I.R.B. 468, provides temporary relief, until the first day of the first plan year that begins after June 30, 2008, for certain pension plans under which the definition of normal retirement age may be required to be changed to comply with the regulations. Accordingly, the final regulations will not be taken into account in the Service's review of plans submitted for determination letters during the Cycle C submission period unless the plan, by its terms, is ineligible for the relief under Notice 2007–69 or the relief ends for the plan before December 31, 2008. (New).

3. *401(a)(4)*:

    - Amendments to § 1.401(a)(4)–8 of the Regulations relating to new comparability plans were published on June 29, 2001 (66 Fed. Reg. 34535). (2004 C. L.).
        - Rev. Rul. 2001–30, 2001–2 C.B. 46. (2004 C. L.).
    - Amendments to § 1.401(a)(4)–9 of the Regulations relating to new comparability plans were published on June 29, 2001 (66 Fed. Reg. 34535). (2005 C. L.).
    - Rev. Rul. 2004–21, 2004–1 C.B. 544. (2005 C. L.).

4. *401(a)(9)*:

    - Sections 1.401(a)(9)–1 through –9 of the Regulations were published on April 17, 2002 and June 15, 2004 (67 Fed. Reg. 18988 and 69 Fed. Reg. 33288). (2004 C. L.).

5. *401(a)(17)*:
Section 401(a)(17) of the Code was amended by § 611(c) of EGTRRA to increase the compensation limit to $200,000. (2004 C. L.).

    - Notice 2001–56, 2001–2 C.B. 277. (2004 C. L.).

6. *401(a)(31)*:

    - Section 401(a)(31) was amended by § 643(b) of EGTRRA to allow employees' after-tax contributions to be rolled over under certain circumstances. (2004 C. L.).
    - Section 401(a)(31)(B) was amended by § 657(a) of EGTRRA (as amended by § 411(t) of JCWAA) to provide for the automatic rollover of certain mandatory distributions. The effective date is March 28, 2005. (2004 C. L.).
        - Notice 2005–2, 2005–1 C.B. 337. (2004 C. L.).
    - Sections 641, 642 and 643 of EGTRRA (as amended by § 411(q) of JCWAA) amended the definition of eligible retirement plan in § 402 of the Code to include a § 403(b) annuity contract and eligible governmental § 457(b) plan. (2004 C. L.).
    - Section 636(b) of EGTRRA modified the definition of eligible rollover distribution to exclude hardship distributions. (2004 C. L.).

7. *401(k) & 401(m)*:

    - Section 401(k)(2) and § 401(k)(10) of the Code were amended by § 646(a)(1) of EGTRRA to permit distributions of elective deferrals from a § 401(k) plan upon severance from employment. (2004 C. L.).
        - Notice 2002–4, 2002–1 C.B. 298. (2004 C. L.).
    - Section 636(a) of EGTRRA directed the Secretary of the Treasury to revise the regulations relating to safe harbor hardship distributions of elective deferrals from § 401(k) plans so that the time the employee is prohibited from making elective and employee contributions is reduced from one year to six months after a hardship distribution. (2004 C. L.).
        - Notice 2001–56. (2004 C. L.).
        - Notice 2002–4. (2004 C. L.).
    - Section 401(k)(11) of the Code was amended by § 611(f) of EGTRRA to increase the maximum amount of qualified salary reduction contributions that can be made to SIMPLE 401(k) plans. (2004 C. L.).
    - Section 402(g) of the Code was amended by § 611(d) of EGTRRA to increase the applicable dollar amount. (2004 C. L.).
    - Section 401(m)(9) of the Code was amended by § 666 of EGTRRA to eliminate the multiple use test. (2004 C. L.).
    - Final Regulations under § 401(k) and § 401(m) of the Code were published on December 29, 2004 (69 Fed. Reg. 78144). (2004 C. L.).
    - Announcement 2007–59, 2007–25 I.R.B. 1448, provides that a plan will not fail to satisfy the requirements of a § 401(k) safe harbor plan because of a mid-year change to implement a designated Roth contribution program. (New).

8. *402A*: Section 402A of the Code was added by § 617 of EGTRRA to offer optional treatment of elective deferrals as designated Roth contributions to defined contribution plans, effective for taxable years beginning after December 31, 2005. (2004 C. L.).

    - Final Regulations under § 401(k) and § 401(m) of the Code relating

to designated Roth contributions were published on January 3, 2006 (71 Fed. Reg. 6). (2005 C. L.).
  - Notice 2006–44, 2006–1 C.B. 889, provides a sample amendment for Roth § 401(k) plans. (2006 C. L.).
- Final Regulations under § 402A of the Code were published on April 30, 2007 (72 Fed. Reg. 21103).[1] (2006 C. L.).

9. *404*:

- Section 404(k)(2)(A) of the Code was amended by § 662(a) of EGTRRA (as amended by § 411(w) of JCWAA) to allow ESOP dividends to be reinvested without the loss of dividend deductions. (2005 C. L.).
  - Notice 2002–2, 2002–1 C.B. 285, provides guidance with respect to the changes made to § 404(k) of the Code and on the effective date of § 409(p) of the Code. (2005 C. L.).

10. *408(q):* Section 408(q) of the Code was added by § 602 of EGTRRA (as amended by § 411(i) of JCWAA) to allow for deemed individual retirement accounts (IRAs) in an eligible retirement plan. (2004 C. L.).

- Section 1.408(q)–1 of the Regulations was published on July 22, 2004 (69 Fed. Reg. 43735). (2004 C. L.).

11. *409*: Section 409(p) of the Code was added by § 656 of EGTRRA relating to restrictions on the allocation of employer securities in an ESOP maintained by an S corporation. (2005 C. L.).

- Section 1.409(p)–1T of the Regulations was published on July 21, 2003 (68 Fed. Reg. 42970). (2005 C. L.).
- Section 1.409(p)–1T of the Regulations was published on December 17, 2004 (69 Fed. Reg. 75455). (2005 C. L.).
- Rev. Proc. 2003–23, 2003–1 C.B. 599, as modified and superseded by Rev. Proc. 2004–14, 2004–1 C.B. 489, allows a direct rollover from an ESOP maintained by an S corporation to an individual retirement plan (IRA). (2005 C. L.).
- Rev. Rul. 2003–6, 2003–1 C.B. 286, provides guidance with respect to whether an ESOP maintained by an S corporation is eligible for the delayed effective date of § 409(p) under § 656(d)(2) of EGTRRA. (2005 C. L.).
- Rev. Rul. 2004–4, 2004–1 C.B. 414, provides guidance relating to synthetic equity owned by a disqualified person in a nonallocation year of an ESOP maintained by an S corporation. (2005 C. L.).
- Final Regulations were published on December 20, 2006 (71 Fed. Reg. 76134) that provide guidance concerning requirements under § 409(p) for ESOPs holding stock of S corporations. (2006 C. L.)._

12. *410(b)*: Final Regulations were published on July 21, 2006 (71 Fed. Reg. 41357) permitting some employees of tax-exempt organizations to be excluded when determining whether a § 401(k) plan meets the § 410(b) minimum coverage requirements. (2006 C. L.).

13. *411(a)*:

- Section 411(a) of the Code was amended by § 633 of EGTRRA (as amended by § 411(o) of JCWAA) to provide for faster vesting of matching contributions. (2004 C. L.).
- Rev. Rul. 2003–65, 2003–1 C.B. 1035. (2005 C. L.).
- Amendments to § 1.411(d)–3 of the Final Regulations were published on August 9, 2006 (71 Fed. Reg. 45379) with respect to the interaction between the anti-cutback rules of § 411(d)(6) and the nonforfeitability requirements of § 411(a). (2006 C. L.).

14. *411(a)(11)*: Section 411(a)(11)(D) of the Code was added by § 648(a) of EGTRRA (as amended by § 411(r) of JCWAA) to allow amounts attributable to rollover contributions to be disregarded in determining the value of an account balance for involuntary distributions. (2004 C. L.).

15. *411(d)(3)*:

- Rev. Rul. 2007–43, 2007–28 I.R.B. 45, provides guidance regarding the partial termination of a defined contribution plan. (New).

16. *411(d)(6)*:

- *Central Laborers' Pension Fund v. Heinz*, 124 S. Ct. 2230 (2004). (2005 C. L.).
  - Rev. Proc. 2005–23, 2005–1 C.B. 991, as modified by Rev. Proc. 2005–76, 2005–2 C.B. 1139. (2005 C. L.).
  - Amendments to § 1.411(d)–3 of the Final Regulations were published on August 9, 2006 (71 Fed. Reg. 45379) with respect to the interaction between the anti-cutback rules of § 411(d)(6) and the nonforfeitability requirements of § 411(a). (2006 C. L.).
- Section 645(b)(3) of EGTRRA directed the Secretary of the Treasury to issue regulations under § 411(d)(6)(B). (2005 C. L.).
  - Section 1.411(d)–3 of the Regulations was published on August 12, 2005 (70 Fed. Reg. 47109). (2005 C. L.).
  - Amendments to § 1.411(d)–3 of the Final Regulations were published on August 9, 2006 (71 Fed. Reg. 45379) with respect to a utilization test. (2006 C. L.).
- Section 411(d)(6)(D) and § 411(d)(6)(E) of the Code were added by § 645 of EGTRRA to permit the elimination of certain optional forms of benefit under certain conditions. (2005 C. L.).
  - Section 1.411(d)–4, Q&A–2(e) of the Regulations was published on January 25, 2005 (70 Fed. Reg. 3475) to implement § 411(d)(6)(E). (2005 C. L.).

[1] Proposed Regulations under § 402A were published on January 26, 2006 (71 Fed. Reg. 4320). (2005 C. L.).

17. *412*:

- Rev. Rul. 2004–20, 2004–1 C.B. 546, provides guidance with respect to whether a qualified pension plan can be a § 412(i) plan if the plan holds life insurance contracts and annuity contracts for benefits at normal retirement age in excess of a participant's benefits at normal retirement age under the plan. (2005 C. L.).
- Notice 2004–59, 2004–2 C.B. 447, provides guidance with respect to restrictions placed on plan amendments following an employer's election of an alternative deficit reduction contribution. (2005 C. L.).

18. *414(v)*: Section 414(v) of the Code was added by § 631 of EGTRRA (as amended by § 411(o) of JCWAA) to allow for catch-up contributions for individuals age 50 or older. (2004 C. L.).

- Regulations under § 414(v) were published on July 8, 2003 (68 Fed. Reg. 40510). (2004 C. L.).
  - Notice 2002–4. (2004 C. L.).

19. *415*:

- Section 415(b) of the Code was amended by § 611 of EGTRRA to increase the dollar limit and change the age when the limit is reduced or increased. (2005 C. L.).
  - Rev. Rul. 2001–51, 2001–2 C.B. 427. (2004 C. L.).
- Section 415(b)(2)(E)(ii) of the Code was amended by § 101(b)(4) of PFEA to fix the percentage at 5.5%. (2005 C. L.).
  - Notice 2004–78, 2004–2 C.B. 879, provides the actuarial assumptions that must be used for distributions with annuity starting dates occurring during the plans years beginning in 2004 and 2005. (2005 C. L.).
- Section 415(c) of the Code was amended by §§ 611(b) and 632 of EGTRRA (as amended by § 411(p) of JCWAA) to increase the maximum annual additions permitted to the lesser of $40,000 or 100% of compensation. (2004 C. L.).
  - Rev. Rul. 2001–51, 2001–2 C.B. 427. (2004 C. L.).
- Rev. Rul. 2002–27, 2002–1 C.B. 925, provided that "compensation" within the meaning of § 415(c) could in certain situations include "deemed § 125 compensation". (2004 C. L.).
- Final Regulations under § 415 with respect to pre-PPA '06 law were published April 5, 2007 (72 Fed. Reg. 16878).[2] (2006 C. L.).
  - See section VI of this notice for PPA '06 provisions related to § 415 that are reflected in the § 415 Final Regulations. (2006 C. L.).

20. *416*: Section 416 of the Code was amended by § 613 of EGTRRA (as amended by § 411(k) of JCWAA) to make several changes to the top-heavy rules. (2004 C. L.).

- Section 416(g)(4)(H) of the Code was added by § 613(d) of EGTRRA to provide certain safe harbor § 401(k) plans and § 401(m) plans an exemption from the top-heavy rules. (2004 C. L.).
  - Rev. Rul. 2004–13, 2004–1 C.B. 485. (2004 C. L.).
- Section 416(c)(1)(C) of the Code was amended by § 613(e) of EGTRRA (as amended by § 411(k)(1) of JCWAA) to provide when a frozen defined benefit plan is exempt from the minimum benefit requirements. (2005 C. L.).

21. *417*:

- Section 1.417(e)–1 of the Regulations was published on July 16, 2003 (68 Fed. Reg. 41906) relating to retroactive annuity starting dates. (2005 C. L.).
- Final Regulations under § 417(a)(3) were published on March 24, 2006 (71 Fed. Reg. 14798) regarding the disclosure of the relative value of optional forms of benefit. (2006 C. L.).

22. *420(c)(3)(A)*: Section 6613 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007, amends § 420(c)(3)(A) regarding minimum cost requirements for transfers of excess pension assets to retiree health accounts. (New)

23. *4975*:

- Section 4975 of the Code was amended by § 612 of EGTRRA to allow plan loans for Subchapter S shareholder-employees. (2004 C. L.)._
- Section 4975(f) of the Code was amended by § 240 of AJCA to allow an S corporation distribution on allocated shares to pay off an exempt loan as long as equal amounts are allocated to participant accounts. (2005 C. L.).

24. *Hurricane Relief*:

- Katrina Emergency Tax Relief Act of 2005, Pub. L. 109–73. (2005 C. L.).
  - Notice 2005–92, 2005–2 C.B. 1165. (2005 C. L.).
- Announcement 2005–70, 2005–2 C.B. 682. (2005 C. L.).
- Gulf Opportunity Zone Act of 2005, Pub. L. 109–135, added § 1400M and § 1400Q to the Code to provide certain tax benefits to those areas affected by Hurricanes Katrina, Wilma, and Rita. (2006 C. L.).

25. *Miscellaneous*:

- Rev. Rul. 2001–62, 2001–2 C.B. 632, provides guidance with respect to the mortality table under § 415(b)(2)(E)(v) of the Code and the applicable mortality table under § 417(e)(3)(A)(ii)(I) of the Code. (2005 C. L.).
- Rev. Rul. 2002–42, 2002–1 C.B. 76, provides guidance with respect to a situation where a money

[2] Section 1.415(c)–2(e) of the Proposed Regulations under § 415 was published on May 31, 2005 (70 Fed. Reg. 31214). (2004 C. L.).

purchase pension plan is merged or converted into a profit sharing plan. (2004 C. L.).

- Rev. Proc. 2002–21, 2002–1 C.B. 911, provides guidance with respect to defined contribution retirement plans maintained by professional employer organizations. (2004 C. L.).
- Rev. Proc. 2003–86, 2003–2 C.B. 1211, amplifies Rev. Proc. 2002–21 relating to relief provided for certain defined contribution plans maintained by professional employer organizations. (2004 C. L.).
- Rev. Rul. 2003–11, 2003–1 C.B. 285, provides guidance with respect to satisfying the nondiscrimination rules under § 401(a)(4) of the Code and the minimum coverage requirements under § 410(b) of the Code when applying the increased compensation limit to former employees. (2005 C. L.).
- Rev. Rul. 2004–10, 2004–1 C.B. 484, provides guidance with respect to charging administrative expenses to former and current employees. (2004 C. L.).
- Rev. Rul. 2004–12, 2004–1 C.B. 478, provides guidance with respect to the distribution restrictions applicable to rollover contributions. (2004 C. L.).
- Rev. Rul. 2005–55, 2005–2 C.B. 284, provides guidance with respect to medical reimbursement accounts under a profit sharing plan. (2005 C. L.).
- Section 1.401(a)–21 of the Final Regulations were published on October 20, 2006 (71 Fed. Reg. 61877) setting forth standards for the use of an electronic medium to applicable notices to recipients or to make participant elections. (2006 C. L.).

The following guidance contains sample or model amendments: Notice 2001–57, 2001–1 C.B. 279 (miscellaneous EGTRRA amendments); Rev. Rul. 2001–62, 2001–2 C.B. 632 (applicable mortality table); Rev. Proc. 2002–29, 2002–2 C.B. 1176 (required minimum distribution amendments); Rev. Proc. 2003–13, 2003–1 C.B. 317 (required language for deemed IRAs); Notice 2005–5 (automatic rollover); and Notice 2006–44, 2006–1 C.B. 889 (Roth § 401(k) plans).

VI. PENSION PROTECTION ACT OF 2006 PROVISIONS

As provided in section IV of this notice, plans submitting in Cycle C may be amended for PPA '06, but the Service will not consider PPA '06 in issuing determination letters. The following list includes PPA '06 provisions effective in 2008 or earlier and guidance relating to those PPA '06 provisions (other than proposed guidance and guidance issued after October 1, 2007).

1. *401(a)(35)*: PPA '06 § 901(a)(1) added § 401(a)(35) requiring that defined contribution plans provide employees with the freedom to divest publicly traded securities. (2006 C. L.).
    - Notice 2006–107, 2006–51 I.R.B. 1114. (2006 C. L.).
2. *401(a)(36)*: PPA '06 § 905(b) added § 401(a)(36) regarding distributions to a participant who has attained age 62 and who has not separated from employment at the time of the distribution. (New).
3. *401(k)*: PPA '06 § 826 modified the rules relating to distributions from a § 401(k) plan on account of a participant's hardship to permit the plan to treat a participant's beneficiary under the plan the same as the participant's spouse or dependent. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding PPA '06 § 826. (2006 C. L.).
    - Announcement 2007–59, 2007–25 I.R.B. 1448, provides that a plan will not fail to satisfy the requirements of a § 401(k) safe harbor plan because of a mid-year change to implement the PPA '06 § 826 hardship withdrawals. (New).
4. *401(k)(2)(B)(i)(V)*: PPA '06 § 827 permits reservists called to active duty after September 11, 2001 and before 2008 to take in-service distributions from a § 401(k) plan. (2006 C. L.).
5. *401(k)(8)(A)(i)*: PPA '06 § 902(e)(3) eliminates the gap period income rule for excess contributions. (New).
6. *401(k)(13)*: PPA '06 § 902 added § 401(k)(13) with respect to automatic contribution arrangements. (New).
7. *401(m)(6)(A)*: PPA '06 § 902(e)(3) eliminates the gap period income rule for excess aggregate contributions. (New).
8. *401(m)(12)*: PPA '06 § 902 added § 401(m)(12) with respect to automatic contribution arrangements. (New).
9. *402(c)(2)(A)*: PPA '06 § 822(a) amended § 402(c)(2)(A) to permit nontaxable distributions from a qualified plan to be directly rolled over tax-free to either another qualified plan or a § 403(b) plan if the separate accounting requirements are met. (2006 C. L.).
10. *402(c)(11)*: PPA '06 § 829(a)(1) added § 402(c)(11) to allow nonspouse beneficiaries to directly roll over distributions from a qualified plan to an individual retirement plan. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding § 402(c)(11). (2006 C. L.).
11. *402(f)*: PPA '06 § 1102(a) provides that notice required to be provided under § 402(f) may be provided as much as 180 days before the annuity starting date. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding PPA '06 § 1102. (2006 C. L.).
12. *408A(e)*: PPA '06 § 824 added § 408A(e) which permits rollovers to Roth IRAs from qualified plans, § 403(b) plans, and § 457 plans. (New).
13. *411*: PPA '06 § 701 provides rules for cash balance plans and other hybrid defined benefit plans. (2006 C. L.).
    - Notice 2007–6, 2007–3 I.R.B. 272, provides guidance regarding

cash balance plans and other hybrid defined benefit plans. (2006 C. L.).

14. *411(a)*: Section 411(a) of the Code was amended by § 904 of PPA '06 to provide for faster vesting of employer nonelective contributions. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding § 411(a), as amended by § 904 of PPA '06. (2006 C. L.).
15. *411(a)(11)*: PPA '06 § 1102(a) provides that notice required to be provided under § 411(a)(11) may be provided as much as 180 days before the annuity starting date. Section 1102(b) of PPA '06 provides that the notice under § 411(a)(11) also include a description of the consequences of failing to defer receipt of a distribution. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding PPA '06 § 1102. (2006 C. L.).
16. *414(d)*: PPA '06 § 906(a)(1) added language to the definition of governmental plan in § 414(d) with respect to Indian tribal governments. (New).
    - Notice 2006–89, 2006–43 I.R.B. 772, provides transition relief for plans subject to PPA '06 § 906. (New).
    - Notice 2007–67, 2007–35 I.R.B. 467, extends the transition relief provided in Notice 2006–89. (New).
17. *414(f)(6)*: PPA '06 § 1106(b) added § 414(f)(6) with respect to a multiemployer status election. Section 6611(a)(2) and (b)(2) of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 amends § 414(f)(6). (New).
18. *414(w)*: PPA '06 § 902(d)(1) added § 414(w) with respect to automatic contribution arrangements. (New).
19. *415(b)(2)(E)(ii)*: Section 415(b)(2)(E)(ii) of the Code was amended by § 303 of PPA '06 regarding the interest rate assumption for applying benefit limitations to lump sum distributions. (2006 C. L.).
    - Final Regulations under § 415 were published April 5, 2007 (72 Fed. Reg. 16878), which provide guidance regarding § 415(b)(2)(E)(ii), as amended by PPA '06. (2006 C. L.).
20. *415(b)(11)*: PPA '06 § 867(a) removed the 100% of compensation limitation for a church plan participant if the participant has never been a highly compensated employee of the church. (2006 C. L.).
    - Final Regulations under § 415 were published April 5, 2007 (72 Fed. Reg. 16878), which provide guidance regarding § 415(b)(11), as added by PPA '06. (2006 C. L.).
21. *415(n)*: PPA '06 § 821 retroactively clarified the rules in § 415(n) relating to the purchase of permissive service credit under defined benefit governmental plans. (New).
22. *417*: PPA '06 § 1102(a) provides that notice required to be provided under § 417 may be provided as much as 180 days before the annuity starting date. (2006 C. L.).
    - Notice 2007–7, 2007–5 I.R.B. 395, provides guidance regarding PPA '06 § 1102. (2006 C. L.).
23. *417(e)(3)*: PPA '06 § 302(b) amended the applicable interest rate and mortality table to be used for determining the present value of lump sum distributions. (New).
24. *417(g)*: PPA '06 § 1004(a)(2) added § 417(g), the qualified optional survivor annuity benefit. (New).
25. *420(e)(2)*: PPA '06 § 114(d)(1) modified the definition of the term "excess pension assets." Section 6612(b) of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 amends § 420(e)(2)(B). (New).
26. *432(c)*: PPA '06 § 212(a) added § 432(c) which requires that a funding improvement plan be adopted for multiemployer plans in endangered status. (New).
27. *432(e)*: PPA '06 § 212(a) added § 432(e) which requires that a rehabilitation plan be adopted for multiemployer plans in critical status. (New).
28. *436*: PPA '06 § 113(a)(1)(B) added § 436 with respect to funding-based limits on benefits and benefit accruals under defined benefit single employer plans. (New).

DRAFTING INFORMATION

The principal author of this notice is Angelique Carrington of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans taxpayer assistance answering service at 1–877–829–5500 (a toll-free number) or Ms. Carrington at *RetirementPlanQuestions@irs.gov*.

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26 CFR 601.201: Rulings and determination letters. (Also, Part I, § 403; § 1.403(b)–3.)

Rev. Proc. 2007–71

SECTION 1. PURPOSE

This revenue procedure provides model plan language that may be used by public schools either to adopt a written plan to reflect the requirements of § 403(b) and the regulations thereunder or to amend its § 403(b) plan to reflect the requirements of § 403(b) and the regulations thereunder. This revenue procedure also provides rules for when plan amendments or a written plan are required to be adopted by public schools or other eligible employers to comply with the recently published final regulations under § 403(b) (72 FR 41128; T.D. 9340). This revenue procedure also provides guidance relating to the application of § 403(b) to certain contracts issued before 2009.

SECTION 2. BACKGROUND AND GENERAL INFORMATION

.01 Section 403(b) applies to contributions made for employees who are performing services for a public school of a

State or a local government or for employees of employers that are tax-exempt organizations under § 501(c)(3). Section 403(b) also applies to contributions made for certain ministers. Under § 403(b), contributions are excluded from gross income only if made to certain funding arrangements: (1) contracts issued by an insurance company qualified to issue annuities in a State that includes payment in the form of an annuity; (2) custodial accounts that are exclusively invested in stock of a regulated investment company (as defined in § 851(a) relating to mutual funds); or (3) a retirement income account for employees of a church-related organization (as defined in §1.403(b)–2 of the Income Tax Regulations).

.02 Final regulations under § 403(b) (T.D. 9340, 2007–36 I.R.B. 487) were published in the **Federal Register** (72 FR 41128) on July 26, 2007 (2007 regulations). The 2007 regulations replaced existing regulations that were published in the **Federal Register** (29 FR 18356) on December 24, 1964, 1965–1 C.B. 180, that provided guidance for complying with § 403(b), as well as certain provisions of regulations that were published in the **Federal Register** (60 FR 49199) on September 22, 1995, relating to eligible rollover distributions and regulations that were that were published in the **Federal Register** (67 FR 18987) on April 17, 2002, relating to minimum distributions under § 401(a)(9). The 2007 regulations reflected the numerous amendments made to § 403(b) by legislation enacted since 1964. Subject to a number of special effective date rules, the 2007 regulations are generally effective for taxable years beginning after December 31, 2008.

.03 The 2007 regulations include comprehensive guidance relating to § 403(b), including the requirement that § 403(b) contracts must be maintained pursuant to a written plan. (References in this revenue procedure to a contract or an issuer include a custodial account under § 403(b)(7) and an issuer of such an account, respectively.) As indicated in the preamble to the regulations, while § 403(b) contracts that are subject to the Employee Retirement Income Security Act of 1974 (ERISA) are already maintained pursuant to written plans, there may be a potential cost associated with satisfying the written plan requirement for those employers that do not have existing plan documents, such as public schools. This revenue procedure is intended to address this concern by providing model plan language that may be used for this purpose by public schools.

.04 Section 1.403(b)–3(b)(3) of the 2007 regulations requires that contracts be issued under a plan, which, in both form and operation, satisfies the requirements of the 2007 regulations and which contains all the material terms and conditions for eligibility, benefits, applicable limitations, the contracts available under the plan, and the time and form under which benefit distributions would be made. Section 1.403(b)–10(b) of the 2007 regulations includes a special rule for situations in which a contract has been exchanged for another contract, under which the successor contract (an "exchange contract") is treated as part of the plan if certain conditions are satisfied, including an information sharing agreement between the employer and the issuer. Section 1.403(b)–11(g) of the 2007 regulations provides that those conditions are not imposed with respect to a contract if the exchange occurred before September 25, 2007, and the exchange satisfied applicable requirements at that time (a "grandfathered exchange contract").

SECTION 3. USE OF MODEL PLAN LANGUAGE BY PUBLIC SCHOOLS

.01 Any public school employer with respect to its employees performing services for it, to the extent provided, may comply with the written plan requirements of the 2007 regulations by adopting the model provision(s) contained in the Appendix to this revenue procedure. The model language has been prepared to take into account the general requirement that a § 403(b) plan include all the material terms and conditions for benefits under the plan. For example, the model language does not incorporate the applicable legal requirements by reference, but instead describes them in a manner intended to enable the plan administrator to implement the plan provisions on the basis of the model language to the extent feasible.

.02 The 2007 regulations provide that a § 403(b) plan, including one established by a public school employer, may contain certain optional features not required to satisfy § 403(b), such as in-service distributions from rollover accounts, distributions for financial hardships, loans, contract exchanges, and plan to plan transfers. If optional provisions are used, the optional provisions must meet, in both form and operation, the relevant requirements under the Code and the 2007 regulations, as well as operate in accordance with the terms of the plan. If a public school employer adopts one or more of these optional model plan language provisions for its § 403(b) plan, the form of the plan will be treated as meeting the requirements under § 403(b) with respect to those provisions.

SECTION 4. RELIANCE BY PUBLIC SCHOOL EMPLOYERS ON MODEL PLAN LANGUAGE

.01 *Amendments.* (a) *Reliance.* If a public school employer amends its plan language to include any portion of the model language, the form of the written plan will be treated as meeting the requirements of § 403(b), to the extent covered by the model plan language that is adopted. This reliance applies only if the employer adopts the model language on a word-for-word basis or adopts an amendment that is substantially similar in all material respects.

(b) *Effect on public schools.* If a public school employer adopts any portion of the model plan language, the written plan must also be operated in accordance with the amendment, from and after the effective date of the amendment, and the § 403(b) plan must continue to satisfy, in both form and operation, all other requirements of § 403(b) in order to maintain § 403(b) status. To the extent a public school employer's § 403(b) plan does not include the model plan language or an amendment that is substantially similar in all respects, a public school that requests a private letter ruling from the Internal Revenue Service (IRS) with respect to the qualification of its § 403(b) written plan must clearly highlight and describe in the written request how its plan provisions differ from the model language.

.02 *Adoption of written plan.* The model language is also designed for use by a public school that does not have a written § 403(b) plan. Thus, adoption of the entire model language (on a word-for-word basis or using language that is substantially similar in all material respects) by a public school has the

same status as a private letter ruling which provides that the written form of the plan satisfies § 403(b). However, if a public school employer adopts the entire model plan language, the § 403(b) written plan must also be operated in accordance with that language, from and after the effective date of adoption, and must continue to satisfy in both form and operation all other requirements of § 403(b) in order for the plan to maintain its § 403(b) status.

SECTION 5. USE OF THE MODEL PLAN LANGUAGE BY EMPLOYERS THAT ARE NOT PUBLIC SCHOOLS

.01 The model plan language in the Appendix to this revenue procedure is designed for use by a public school employer with respect to its employees. The model language is intended for a basic plan under which contributions are limited to pre-tax elective deferrals (without any designated Roth, employer matching, or other employer nonelective contributions). An eligible employer that is not a public school may use the provisions of the Appendix as sample language to comply with one or more of the requirements imposed by the 2007 regulations issued under § 403(b).

.02 Because the model plan language in the Appendix has been designed for a State or local government with respect to its employees performing services for a public school, a § 501(c)(3) organization must determine the extent to which the model language is appropriate for use in connection with its § 403(b) plan to comply with one or more of the requirements imposed by the regulations issued under § 403(b). Notes in the Appendix identify the principal provisions which require modification for use by an eligible employer that is not a public school maintaining a § 403(b) arrangement. Moreover, if an eligible employer that is not a public school uses the model language in the Appendix, additional or revised provisions may be necessary or appropriate in order to comply with the 2007 regulations and, if applicable, ERISA, especially if either (i) the plan is not limited to elective deferrals, (ii) the plan is designed to not be an employee pension benefit plan under ERISA in accordance with 29 CFR 2510.3–2(f) of the Department of Labor Regulations, or (iii) the plan is maintained by a church (or a church-related organization described in § 414(e)(3)(A) or a qualified church-controlled organization under § 3121(w)(3)(B)) or applies with respect to one or more ministers.[1]

.03 Adoption of the model plan language contained in the Appendix by an eligible employer that is not a public school does not have the same status as a private letter ruling with respect to the adopted language. However, if an eligible employer that is not a public school has received from the IRS a favorable private letter ruling under § 403(b), then, except as provided in section 5.02 of this revenue procedure, the eligible employer's adoption of appropriate plan model language contained in the Appendix will not result in the loss of its reliance on the private letter ruling for periods prior to the effective date of the 2007 regulations.

SECTION 6. DATE AMENDMENTS ARE ADOPTED

Pursuant to this revenue procedure, a § 403(b) plan will be treated as having been amended timely to reflect a requirement of the 2007 regulations if an amendment that satisfies that requirement (such as the model language in the Appendix of this revenue procedure that reflects that requirement) is adopted no later than the first day of the first taxable year beginning after December 31, 2008, the amendment is effective as of the applicable effective date of the requirement under the 2007 regulations, and the written plan is operated as if that amendment is in effect. This section 6 applies to the requirement to have a written plan. However, for a special rule with respect to amendments made pursuant to the Pension Protection Act of 2006, Public Law 109–280 (PPA '06), see section 1107 of the PPA '06.

SECTION 7. AREAS NOT COVERED BY SECTIONS 3 AND 4 OF THIS REVENUE PROCEDURE

Except as provided in section 5 of this revenue procedure, the model plan language referenced in sections 3 and 4 of this revenue procedure is not designed to apply to any employer other than a State or local government with respect to its employees performing services for a public school.

SECTION 8. GUIDANCE REGARDING CERTAIN CONTRACTS ISSUED BEFORE 2009

.01 *Contracts issued before 2009 as part of employer's plan.* In the case of a contract issued after December 31, 2004 and before January 1, 2009 by an issuer that does not receive contributions under the plan in a year after the contract was issued (*e.g.*, due to the issuer having been discontinued as an issuer under the plan or the issuer having become an issuer under the plan due to the contract having been issued in a post-September 24, 2007 exchange permitted under Rev. Rul. 90–24, 1990–1 C.B. 97), the contract will not fail to satisfy § 403(b) for the year merely because the contract is not part of a written plan that satisfies § 1.403(b)–3(b)(3) of the 2007 regulations if the employer makes a reasonable, good faith effort to include the contract as part of the employer's plan that satisfies § 1.403(b)–3(b)(3) of the 2007 regulations. For this purpose, a reasonable, good faith effort to include those contracts as part of the employer's plan includes collecting available information concerning those issuers (for which purpose, the information is not required to be collected for issuers that ceased to receive contributions before January 1, 2005) and notifying them of the name and contact information for the person in charge of administering the employer's plan for the purpose of coordinating information necessary to satisfy § 403(b). As an alternative to the actions described in the preceding sentence, a reasonable, good faith effort to include that contract as part of the employer's plan also includes the issuer taking action before making any distribution or loan to the participant or beneficiary which constitutes a reasonable, good faith effort to contact the employer and exchange any information that may be needed in order to satisfy § 403(b) with the person in charge of administering the employer's plan.

.02 *Contracts issued before 2009 held for former employees or beneficiaries.* In the case of an issuer that holds § 403(b) contracts under a § 403(b) plan, but which

[1] *See* United States Department of Labor Field Assistance Bulletin No. 2007–02.

ceases to receive contributions before January 1, 2009 (*e.g.*, due to the issuer having been discontinued as an issuer under the plan, the employer having ceased to exist, or the issuer having become an issuer under the plan due to the contract having been issued in a post-September 24, 2007 exchange permitted under Rev. Rul. 90–24, 1990–1 C.B. 97), those contracts continue to be subject to the requirements of § 403(b) and the 2007 regulations to the extent applicable. However, pursuant to this revenue procedure, a § 403(b) plan will not be treated as failing to satisfy the requirements of § 1.403(b)–3(b)(3) if the plan does not include terms relating to those contracts. If the participant or beneficiary requests a loan from the contract in accordance with § 72(p)(2), this relief applies only if the issuer makes such a loan only after the issuer has made reasonable efforts to determine: (1) whether the participant or beneficiary has in the prior 12 months had any other outstanding loans from qualified employer plans of the employer (taking into account §§ 72(p)(2)(D) and 72(p)(5)); and (2) if the participant or beneficiary has had any such loans, the highest outstanding balance of such loans during that period. For this purpose, assuming the employer is still in existence at the time of the loan, mere reliance on information from the participant or beneficiary about outstanding loans does not constitute reasonable efforts to determine whether the participant or beneficiary has other outstanding loans from plans of the employer.

The special rules in this section 8.02 apply only with respect to a contract that has been issued before January 1, 2009, under a § 403(b) plan that is held on behalf of a participant who, on January 1, 2009, is a former employee of the employer or for a beneficiary. For this purpose, the issuer can rely on information from the participant as to whether the participant is a former employee, assuming that reliance on that information is not unreasonable under the facts and circumstances.

8.03. *Re-exchange back into plan.* If, after September 24, 2007 and before January 1, 2009, a contract is issued in an exchange permitted under Rev. Rul. 90–24 (an "intermediate contract") and, before July 1, 2009, the contract is exchanged in accordance with Rev. Rul. 90–24 for a contract issued by an issuer which is either receiving contributions as part of the plan or has an information sharing agreement as set forth in § 1.403(b)–10(b)(2)(i)(C)(*1*) and (*2*) of the 2007 regulations, then the information sharing conditions in § 1.403(b)–10(b)(2)(i)(C)(*1*) and (*2*) of the 2007 regulations do not apply to the intermediate contract.

8.04. *Information sharing agreements.* The model plan in this revenue procedure includes optional provisions in Section 6.4(a) through (d) to allow contract exchanges with an issuer that is not receiving contributions. See Section 6.4(d) of the model language for the type of information that would satisfy the information sharing agreement conditions in § 1.403(b)–10(b)(2)(i)(C)(*1*) and (*2*) of the 2007 regulations.

SECTION 9. COMMENTS REQUESTED

Treasury and IRS are interested in receiving comments on the model language contained in this revenue procedure and any other model language that interested parties believe should be added to this revenue procedure. Comments are specifically requested on the following questions. While the model language has generally been prepared for use by employers based on provisions commonly found in defined contribution retirement plans, are there additional provisions which should be added to reflect features that are widely used? Are there changes that should especially be made to reflect the circumstances applicable to public schools, including not only revised versions of the model language, but also whether additional provisions are necessary or appropriate for them? Should the provisions found in section 7.3 of the model language, which have been prepared to satisfy the 2007 final regulations requirements for the plan document to reflect the available vendors, be expanded, including changes to reflect the special relief in section 8 of this revenue procedure?

Comments should be sent to the following address: Internal Revenue Service, Attn: CC:PA:LPD:PR (Rev. Proc. 2007–71), Room 5203, P. O. Box 7604, Ben Franklin Station, Washington, DC 20044. Written comments may be hand delivered Monday through Friday between 8 a.m. and 4 p.m. to: Internal Revenue Service, Courier's Desk, Attn: CC:PA:RU (Section 403(b) Plans), 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, written comments may be submitted electronically via the Internet to *notice.comments@irscounsel.treas.gov* (Rev. Proc. 2007–71). Comments should be received by March 16, 2008.

SECTION 10. EFFECTIVE DATE

This revenue procedure is effective December 17, 2007.

DRAFTING INFORMATION

The principal author of this revenue procedure is Robert Architect of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans taxpayer assistance telephone service at (877) 829–5500 (a toll-free number) between the hours of 8:30 am and 4:30 pm Eastern Time, Monday through Friday. Mr. Architect may be e-mailed at *RetirementPlanQuestions@irs.gov*.

APPENDIX FOR REVENUE PROCEDURE 2007–71
MODEL PLAN LANGUAGE

***Note to sponsors:** The model language in this Appendix is designed primarily for use by a public school in order for it to offer its employees the ability to elect to make pre-tax elective deferrals in accordance with § 403(b) of the Internal Revenue Code. (See section 5 of the revenue procedure for use of the model language by an organization that is a tax-exempt organization under § 501(c)(3) or for a church entity.) In addition, the contributions permitted under the model language are limited to pre-tax elective deferrals, and it is assumed that the plan is maintained on the basis of the calendar year. This model language is not designed for a plan that provides for matching contributions or other employer nonelective contributions, or for adoption by any other type of employer. The model language also includes certain optional alternatives, including an alternative under which the plan may automatically enroll employees for elective deferrals (or alternatively to enroll only employees who file an affirmative election) and an alternative under which the plan may permit a contract issued under the plan by a vendor to whom contributions are made to be exchanged for a contract issued by vendors to whom contributions are not made under the plan.*

The portions of this Appendix printed in italics are explanatory notes for the benefit of the public school plan sponsor and thus are not to be included in the model plan document. In addition, certain items indicated by brackets can be filled in by the plan sponsor as appropriate.

Section 403(b) Model Plan Language for a Public School

Section 1
Definition of Terms Used

The following words and terms, when used in the Plan, have the meaning set forth below.

1.1 **"Account"**: The account or accumulation maintained for the benefit of any Participant or Beneficiary under an Annuity Contract or a Custodial Account.

1.2 **"Account Balance"**: The bookkeeping account maintained for each Participant which reflects the aggregate amount credited to the Participant's Account under all Accounts, including the Participant's Elective Deferrals, the earnings or loss of each Annuity Contract or a Custodial Account (net of expenses) allocable to the Participant, any transfers for the Participant's benefit, and any distribution made to the Participant or the Participant's Beneficiary. If a Participant has more than one Beneficiary at the time of the Participant's death, then a separate Account Balance shall be maintained for each Beneficiary. The Account Balance includes any account established under Section 6 for rollover contributions and plan-to-plan transfers made for a Participant, the account established for a Beneficiary after a Participant's death, and any account or accounts established for an alternate payee (as defined in section 414(p)(8) of the Code).

***Note:** A vendor is not required to maintain a separate account for each beneficiary in order to satisfy § 401(a)(9), but this sample plan language provides for such separate accounts so that installment payments are permitted to be made over each beneficiary's life expectancy as permitted under § 1.401(a)(9)–8, A–2(a)(2) of the Income Tax Regulations. However, because, under the sample plan language, each separate account is permitted to have only a single beneficiary, certain beneficiary designations are not permitted under the sample plan language, such as a death benefit in the form of a fixed dollar payment that is not determined as of the date of death and that is not to be maintained in a separate account to which gains and losses are credited.*

1.3 **"Administrator"**: [INSERT IDENTITY OF PERSON, COMMITTEE, OR ORGANIZATION APPOINTED TO ADMINISTER THE PLAN].

1.4 **"Annuity Contract"**: A nontransferable contract as defined in section 403(b)(1) of the Code, established for each Participant by the Employer, or by each Participant individually, that is issued by an insurance company qualified to issue annuities in [Insert name of State] and that includes payment in the form of an annuity.

1.5 **"Beneficiary"**: The designated person who is entitled to receive benefits under the Plan after the death of a Participant, subject to such additional rules as may be set forth in the Individual Agreements.

1.6 **"Custodial Account"**: The group or individual custodial account or accounts, as defined in section 403(b)(7) of the Code, established for each Participant by the Employer, or by each Participant individually, to hold assets of the Plan.

1.7 **"Code"**: The Internal Revenue Code of 1986, as now in effect or as hereafter amended. All citations to sections of the Code are to such sections as they may from time to time be amended or renumbered.

1.8 **"Compensation"**: All cash compensation for services to the Employer, including salary, wages, fees, commissions, bonuses, and overtime pay, that is includible in the Employee's gross income for the calendar year, plus amounts that would be cash compensation for services to the Employer includible in the Employee's gross income for the calendar year but for a compensation reduction election under section 125, 132(f), 401(k), 403(b), or 457(b) of the Code (including an election under Section 2 made to reduce compensation in order to have Elective Deferrals under the Plan).

1.9 **"Disabled"**: The definition of disability provided in the applicable Individual Agreement.

1.10 **"Elective Deferral"**: The Employer contributions made to the Plan at the election of the Participant in lieu of receiving cash compensation. Elective Deferrals are limited to pre-tax salary reduction contributions.

1.11 **"Employee"**: Each individual, whether appointed or elected, who is a common law employee of the Employer performing services for a public school as an employee of the Employer. This definition is not applicable unless the employee's compensation for performing services for a public school is paid by the Employer. Further, a person occupying an elective or appointive public office is not an employee performing services for a public school unless such office is one to which an individual is elected or appointed only if the individual has received training, or is experienced, in the field of education. A public office includes any elective or appointive office of a State or local government.

1.12 **"Employer"**: [NAME OF PUBLIC SCHOOL].

Note: *The definitions of "Employee" and "Employer" are specifically tailored for use by a State or local government maintaining a § 403(b) plan for its employees who perform services for a public school and must be modified for use by any other employer.*

1.13 **"Funding Vehicles"**: The Annuity Contracts or Custodial Accounts issued for funding amounts held under the Plan and specifically approved by the Employer for use under the Plan.

1.14 **"Includible Compensation"**: An Employee's actual wages in box 1 of Form W–2 for a year for services to the Employer, but subject to a maximum of $200,000 (or such higher maximum as may apply under section 401(a)(17) of the Code) and increased (up to the dollar maximum) by any compensation reduction election under section 125, 132(f), 401(k), 403(b), or 457(b) of the Code (including any Elective Deferral under the Plan). The amount of Includible Compensation is determined without regard to any community property laws.

1.15 **"Individual Agreement"**: The agreements between a Vendor and the Employer or a Participant that constitutes or governs a Custodial Account or an Annuity Contract.

1.16 **"Participant"**: An individual for whom Elective Deferrals are currently being made, or for whom Elective Deferrals have previously been made, under the Plan and who has not received a distribution of his or her entire benefit under the Plan.

1.17 **"Plan"**: [INSERT NAME OF PLAN].

1.18 **"Plan year"**: The calendar year.

1.19 **"Related Employer"**: The Employer and any other entity which is under common control with the Employer under section 414(b) or (c) of the Code. For this purpose, the Employer shall determine which entities are Related Employers based on a reasonable, good faith standard and taking into account the special rules applicable under Notice 89–23, 1989–1 C.B. 654.

Note: *The definition of "Related Employer" is specifically tailored for use by a State or local government maintaining a § 403(b) plan for its employees who perform services for a public school and must be modified for use by any other employer by deleting the sentence in Section 1.19 that begins "For this purpose ..." because Notice 89–23 only applies to employers that are State or local public schools and churches. See § 1.414(c)–5 of the Income Tax Regulations (and the related discussion at pages 41137 and 41138 of the* **Federal Register** *(72 FR 41128) in the preamble to those regulations).*

1.20 **"Severance from Employment"**: For purpose of the Plan, Severance from Employment means Severance from Employment with the Employer and any Related Entity. However, a Severance from Employment also occurs on any date on which an Employee ceases to be an employee of a public school, even though the Employee may continue to be employed by a Related Employer that is another unit of the State or local government that is not a public school or in a capacity that is not employment with a public school (*e.g.*, ceasing to be an employee performing services for a public school but continuing to work for the same State or local government employer).

Note: The definition of "Severance from Employment" is specifically tailored for use by a State or local government maintaining a § 403(b) plan for its employees who perform services for a public school and must be modified for use by any other employer.

1.21 **"Vendor"**: The provider of an Annuity Contract or Custodial Account.

1.22 **"Valuation Date"**: [Each business day/The last day of the calendar month/The last day of the calendar quarter/ Each December 31].

Section 2
Participation and Contributions

2.1 ***Eligibility.*** Each Employee shall be eligible to participate in the Plan and elect to have Elective Deferrals made on his or her behalf hereunder immediately upon becoming employed by the Employer. However, an Employee who is a student-teacher (*i.e.*, a person providing service as a teacher's aid on a temporary basis while attending a school, college or university) or who normally works fewer than 20 hours per week is not eligible to participate in the Plan. An Employee normally works fewer than 20 hours per week if, for the 12-month period beginning on the date the employee's employment commenced, the Employer reasonably expects the Employee to work fewer than 1,000 hours of service (as defined under section 410(a)(3)(C) of the Code) and, for each plan year ending after the close of that 12-month period, the Employee has worked fewer than 1,000 hours of service.

Note: *This model language assumes that the plan has immediate eligibility, that the plan is limited to pre-tax elective deferrals, and that the plan has no matching or other employer non-elective contributions.*

The model language in Section 2.1 also assumes that employees who normally work fewer than 20 hours per week or who are student-teachers are not eligible. Either of these exclusions may be deleted on a uniform basis for all employees. If this model language is used by a § 501(c)(3) employer that is not a public school and the plan is subject to ERISA, the plan should delete the exclusion for employees who normally work fewer than 20 hours per week.

2.2 ***Compensation Reduction Election.*** (a) ***General Rule.*** An Employee elects to become a Participant by executing an election to reduce his or her Compensation (and have that amount contributed as an Elective Deferral on his or her behalf) and filing it with the Administrator. This Compensation reduction election shall be made on the agreement provided by the Administrator under which the Employee agrees to be bound by all the terms and conditions of the Plan. The Administrator may establish an annual minimum deferral amount no higher than $200, and may change such minimum to a lower amount from time to time. The participation election shall also include designation of the Funding Vehicles and Accounts therein to which Elective Deferrals are to be made and a designation of Beneficiary. Any such election shall remain in effect until a new election is filed. Only an individual who performs services for the Employer as an Employee may reduce his or her Compensation under the Plan. Each Employee will become a Participant in accordance with the terms and conditions of the Individual Agreements. All Elective Deferrals shall be made on a pre-tax basis. An Employee shall become a Participant as soon as administratively practicable following the date applicable under the employee's election.

(b) ***Special Rule for New Employees.*** (1) ***Automatic Enrollment for New Employees.*** For purposes of applying this Section 2.2, a new Employee is deemed to have elected to become a Participant and to have his or her Compensation reduced by [5%] (and have that amount contributed as an Elective Deferral on his or her behalf), at the time the Employee is hired, and to have agreed to be bound by all the terms and conditions of the Plan. Contributions made under this automatic participation provision shall be made to the Funding Vehicle or Vehicles selected for this purpose for all new Employees by the Administrator. Any Employee who automatically becomes a Participant under this Section 2.2(b) shall file a designation of Beneficiary with the Funding Vehicle or Vehicles to which contributions are made.

(2) ***Right to File a Different Election; Notice to Employee***. This Section 2.2(b) shall not apply to the extent an Employee files an election for a different percentage reduction or elects to have no Compensation reduction, or designates a different Funding Vehicle to receive contributions made on his or her behalf. Any new Employee shall receive a statement at the time he or she is hired that describes the Employee's rights and obligations under this Section 2.2(b) (including the information in this Section 2.2(b) and identification of how the Employee can file an election or make a designation as described in the preceding sentence, and the refund right under Section 2.2(b)(3), including the specific name and location of the person to whom any such election or designation may be filed), and how the contributions under this Section 2.2(b) will be invested.

(3) ***Refund of Contributions***. An Employee for whom contributions have been automatically made under Section 2.2(b)(1) may elect to withdraw all of the contributions made on his or her behalf under Section 2.2(b)(1), including earnings thereon to the date of the withdrawal. This withdrawal right is available only if the withdrawal election is made within 90 days after the date of the first contribution made under Section 2.2(b)(1).

Note: *Section 2.2(b) is an optional provision that provides for any new employee to be automatically enrolled in the Plan, with 5% of Compensation to be contributed to the Plan, unless the employee elects otherwise. See §§ 414(w) and 4979(f) of the Code for special relief that applies to a plan that uses automatic enrollment, as provided in Section 2.2(b). Plan sponsors should make any revisions in this optional provision that may be necessary in order to take into account any additional guidance that may be provided by the Treasury Department or the IRS regarding automatic enrollment under §§ 414(w) and 4979(f) of the Code.*

2.3 ***Information Provided by the Employee.*** Each Employee enrolling in the Plan should provide to the Administrator at the time of initial enrollment, and later if there are any changes, any information necessary or advisable for the Administrator to administer the Plan, including any information required under the Individual Agreements.

2.4 ***Change in Elective Deferrals Election.*** Subject to the provisions of the applicable Individual Agreements, an Employee may at any time revise his or her participation election, including a change of the amount of his or her Elective Deferrals, his or her investment direction, and his or her designated Beneficiary. A change in the investment direction shall take effect as of the date provided by the Administrator on a uniform basis for all Employees. A change in the Beneficiary designation shall take effect when the election is accepted by the Vendor.

2.5 ***Contributions Made Promptly.*** Elective Deferrals under the Plan shall be transferred to the applicable Funding Vehicle within 15 business days following the end of the month in which the amount would otherwise have been paid to the Participant.

2.6 ***Leave of Absence***. Unless an election is otherwise revised, if an Employee is absent from work by leave of absence, Elective Deferrals under the Plan shall continue to the extent that Compensation continues.

Note: *If this Section 2 is adopted separately, the following definitions from Section 1 should also be adopted: Account, Administrator, Beneficiary, Compensation, Elective Deferral, Employee, Employer, Funding Vehicles, Individual Agreement, Participant, Plan, and Vendor.*

Section 3
Limitations on Amounts Deferred

3.1 ***Basic Annual Limitation.*** Except as provided in Sections 3.2 and 3.3, the maximum amount of the Elective Deferral under the Plan for any calendar year shall not exceed the lesser of (a) the applicable dollar amount or (b) the Participant's Includible Compensation for the calendar year. The applicable dollar amount is the amount established under section 402(g)(1)(B) of the Code, which is $15,500 for 2007, and is adjusted for cost-of-living after 2007 to the extent provided under section 415(d) of the Code.

3.2 ***Special Section 403(b) Catch-up Limitation for Employees With 15 Years of Service***. Because the Employer is a qualified organization (within the meaning of § 1.403(b)–4(c)(3)(ii) of the Income Tax Regulations), the applicable dollar amount under Section 3.1(a) for any "qualified employee" is increased (to the extent provided in the Individual Agreements) by the least of:

(a) $3,000;

(b) The excess of:

(1) $15,000, over

(2) The total special 403(b) catch-up elective deferrals made for the qualified employee by the qualified organization for prior years; or

(c) The excess of:

(1) $5,000 multiplied by the number of years of service of the employee with the qualified organization, over

(2) The total Elective Deferrals made for the employee by the qualified organization for prior years.

For purposes of this Section 3.2, a "qualified employee" means an employee who has completed at least 15 years of service taking into account only employment with the Employer.

Note: Section 3.2 is specifically written for use by a State or local government maintaining a § 403(b) plan for its employees who perform services for a public school and, if used by a § 501(c)(3) employer, must be limited to cases in which the Employer is a "qualified organization" under § 1.403(b)–4(c)(3)(iii) of the Income Tax Regulations.

3.3 ***Age 50 Catch-up Elective Deferral Contributions.*** An Employee who is a Participant who will attain age 50 or more by the end of the calendar year is permitted to elect an additional amount of Elective Deferrals, up to the maximum age 50 catch-up Elective Deferrals for the year. The maximum dollar amount of the age 50 catch-up Elective Deferrals for a year is $5,000 for 2007, and is adjusted for cost-of-living after 2007 to the extent provided under the Code.

3.4 ***Coordination***. Amounts in excess of the limitation set forth in Section 3.1 shall be allocated first to the special 403(b) catch-up under Section 3.2 and next as an age 50 catch-up contribution under Section 3.3. However, in no event can the amount of the Elective Deferrals for a year be more than the Participant's Compensation for the year.

3.5 ***Special Rule for a Participant Covered by Another Section 403(b) Plan.*** For purposes of this Section 3, if the Participant is or has been a participant in one or more other plans under section 403(b) of the Code (and any other plan that permits elective deferrals under section 402(g) of the Code), then this Plan and all such other plans shall be considered as one plan for purposes of applying the foregoing limitations of this Section 3. For this purpose, the Administrator shall take into account any other such plan maintained by any Related Employer and shall also take into account any other such plan for which the Administrator receives from the Participant sufficient information concerning his or her participation in such other plan. Notwithstanding the foregoing, another plan maintained by a Related Entity shall be taken into account for purposes of Section 3.2 only if the other plan is a § 403(b) plan.

3.6 ***Correction of Excess Elective Deferrals.*** If the Elective Deferral on behalf of a Participant for any calendar year exceeds the limitations described above, or the Elective Deferral on behalf of a Participant for any calendar year exceeds the limitations described above when combined with other amounts deferred by the Participant under another plan of the employer under section 403(b) of the Code (and any other plan that permits elective deferrals under section 402(g) of the Code for which the Participant provides information that is accepted by the Administrator), then the Elective Deferral, to the extent in excess of the applicable limitation (adjusted for any income or loss in value, if any, allocable thereto), shall be distributed to the Participant.

Note: *Corrective distributions are generally required to be made within 2½ months after the end of the calendar year, but can be made within 6 months after the end of the calendar year if the plan uses the optional provision at Section 2.2(b) and otherwise constitutes an eligible automatic contribution arrangement. See §§ 414(w)(3) and 4979(f) of the Code.*

3.7 ***Protection of Persons Who Serve in a Uniformed Service.*** An Employee whose employment is interrupted by qualified military service under section 414(u) of the Code or who is on a leave of absence for qualified military service under section 414(u) of the Code may elect to make additional Elective Deferrals upon resumption of employment with the Employer equal to the maximum Elective Deferrals that the Employee could have elected during that period if the Employee's employment with the Employer had continued (at the same level of Compensation) without the interruption or leave, reduced by the Elective Deferrals, if any, actually made for the Employee during the period of the interruption or leave. Except to the extent provided under section 414(u) of the Code, this right applies for five years following the resumption of employment (or, if sooner, for a period equal to three times the period of the interruption or leave).

Note: *If this Section 3 is adopted separately, the following definitions from Section 1 should also be adopted: Administrator, Code, Compensation, Elective Deferral, Employee, Employer, Includible Compensation, Participant, Plan, and Related Employer.*

Section 4
Loans

4.1 ***Loans***. Loans shall be permitted under the Plan to the extent permitted by the Individual Agreements controlling the Account assets from which the loan is made and by which the loan will be secured.

4.2 ***Information Coordination Concerning Loans.*** Each Vendor is responsible for all information reporting and tax withholding required by applicable federal and state law in connection with distributions and loans. To minimize the instances in which Particpants have taxable income as a result of loans from the Plan, the Administrator shall take such steps as may be appropriate to coordinate the limitations on loans set forth in Section 4.3, including the collection of information from Vendors, and transmission of information requested by any Vendor, concerning the outstanding balance of any loans made to a Participant under the Plan or any other plan of the Employer. The Administrator shall also take such steps as may be appropriate to collect information from Vendors, and transmission of information to any Vendor, concerning any failure by a Participant to repay timely any loans made to a Participant under the Plan or any other plan of the Employer.

4.3 ***Maximum Loan Amount.*** No loan to a Participant under the Plan may exceed the lesser of:

(a) $50,000, reduced by the greater of (i) the outstanding balance on any loan from the Plan to the Participant on the date the loan is made or (ii) the highest outstanding balance on loans from the Plan to the Participant during the one-year period ending on the day before the date the loan is approved by the Administrator (not taking into account any payments made during such one-year period); or

(b) one half of the value of the Participant's vested Account Balance (as of the valuation date immediately preceding the date on which such loan is approved by the Administrator).

For purposes of this Section 4.3, any loan from any other plan maintained by the Employer and any Related Employer shall be treated as if it were a loan made from the Plan, and the Participant's vested interest under any such other plan shall be considered a vested interest under this Plan; provided, however, that the provisions of this paragraph shall not be applied so as to allow the amount of a loan to exceed the amount that would otherwise be permitted in the absence of this paragraph.

Note: *Loans are included in taxable income under certain conditions, including: if the loan, when combined with the balance of all other loans from plans of the employer, exceeds the limitations described in Section 4.3; or if there is a failure to repay the loan in accordance with the repayment schedule. Because the tax treatment of a loan depends on information concerning aggregate loan balances under all annuity contracts and custodial accounts within the Plan (and under all plans of the employer), information about loan balances under the contracts and accounts of other vendors is needed before making a loan. That information may be obtained from the participant, but this sample language provides for the Administrator also to collect and coordinate that information in order to decrease the instances in which participants have taxable income from plan loans.*

Note: *See § 1.72(p)–1 of the Income Tax Regulations for the federal income tax treatment of loans generally.*

Note: *If this Section 4 is adopted separately, the following definitions from Section 1 should also be adopted: Account, Administrator, Account Balance, Employer, Individual Agreement, Participant, Plan, Related Employer, Valuation Date, and Vendor.*

Section 5
Benefit Distributions

5.1 ***Benefit Distributions At Severance from Employment or Other Distribution Event***. Except as permitted under Section 3.6 (relating to excess Elective Deferrals), Section 5.4 (relating to withdrawals of amounts rolled over into the Plan), Section 5.5 (relating to hardship), or Section 8.3 (relating to termination of the Plan), distributions from a Participant's Account may not be made earlier than the earliest of the date on which the Participation has a Severance from Employment, dies, becomes Disabled, or attains age 59½. Distributions shall otherwise be made in accordance with the terms of the Individual Agreements.

5.2 ***Small Account Balances***. The terms of the Individual Agreement may permit distributions to be made in the form of a lump-sum payment, without the consent of the Participant or Beneficiary, but no such payment may be made without the consent of the Participant or Beneficiary unless the Account Balance does not exceed $5,000 (determined without regard to any separate account that holds rollover contributions under Section 6.1) and any such distribution shall comply with the requirements of section 401(a)(31)(B) of the Code (relating to automatic distribution as a direct rollover to an individual retirement plan for distributions in excess of $1,000).

5.3 ***Minimum Distributions***. Each Individual Agreement shall comply with the minimum distribution requirements of section 401(a)(9) of the Code and the regulations thereunder. For purposes of applying the distribution rules of section 401(a)(9) of the Code, each Individual Agreement is treated as an individual retirement account (IRA) and distributions shall be made in accordance with the provisions of § 1.408–8 of the Income Tax Regulations, except as provided in § 1.403(b)–6(e) of the Income Tax Regulations.

Note: *This Section 5.3 assumes that each individual agreement with a vendor complies with the minimum distribution requirements of § 401(a)(9) of the Code. See section 5 of the Appendix for Rev. Proc. 2004–56, 2004–2 C.B. 376, for model language that may be used to set forth the minimum distribution requirements of § 401(a)(9) of the Code.*

5.4 ***In-Service Distributions From Rollover Account.*** If a Participant has a separate account attributable to rollover contributions to the plan, to the extent permitted by the applicable Individual Agreement, the Participant may at any time elect to receive a distribution of all or any portion of the amount held in the rollover account.

Note: *A plan is not required to permit in-service distribution from a rollover account. See Rev. Rul. 2004–12, 2004–1 C.B. 478.*

5.5 ***Hardship Withdrawals***. (a) Hardship withdrawals shall be permitted under the Plan to the extent permitted by the Individual Agreements controlling the Account assets to be withdrawn to satisfy the hardship. If applicable under an Individual Agreement, no Elective Deferrals shall be allowed under the Plan during the 6-month period beginning on the date the Participant receives a distribution on account of hardship.

(b) The Individual Agreements shall provide for the exchange of information among the Employer and the Vendors to the extent necessary to implement the Individual Agreements, including, in the case of a hardship withdrawal that is automatically deemed to be necessary to satisfy the Participant's financial need (pursuant to § 1.401(k)–1(d)(3)(iv)(E) of the Income Tax Regulations), the Vendor notifying the Employer of the withdrawal in order for the Employer to implement the resulting 6-month suspension of the Participant's right to make Elective Deferrals under the Plan. In addition, in the case of a hardship withdrawal that is not automatically deemed to be necessary to satisfy the financial need (pursuant to § 1.401(k)–1(d)(3)(iii)(B) of the Income Tax Regulations), the Vendor shall obtain information from the Employer or other Vendors to determine the amount of any plan loans and rollover accounts that are available to the Participant under the Plan to satisfy the financial need.

5.6 ***Rollover Distributions***. (a) A Participant or the Beneficiary of a deceased Participant (or a Participant's spouse or former spouse who is an alternate payee under a domestic relations order, as defined in section 414(p) of the Code) who is entitled to an eligible rollover distribution may elect to have any portion of an eligible rollover distribution (as defined in section 402(c)(4) of the Code) from the Plan paid directly to an eligible retirement plan (as defined in section 402(c)(8)(B) of the Code) specified by the Participant in a direct rollover. In the case of a distribution to a Beneficiary who at the time of the Participant's death was neither the spouse of the Participant nor the spouse or former spouse of the Participant who is an alternate payee under a domestic relations order, a direct rollover is payable only to an individual retirement account or individual retirement annuity (IRA) that has been established on behalf of the Beneficiary as an inherited IRA (within the meaning of section 408(d)(3)(C) of the Code).

(b) Each Vendor shall be separately responsible for providing, within a reasonable time period before making an initial eligible rollover distribution, an explanation to the Participant of his or her right to elect a direct rollover and the income tax withholding consequences of not electing a direct rollover.

Note: *Section 402(f) of the Code requires a plan administrator to provide a written explanation to any recipient of an eligible rollover distribution. The written explanation must cover the direct rollover rules, the mandatory income tax withholding on distributions not directly rolled over, the tax treatment of distributions not rolled over (including the special tax treatment available for certain lump sum distributions), and when distributions may be subject to different restrictions and tax consequences after being rolled over. Section 402(f) provides that this explanation must be given within a reasonable period of time before the plan makes an eligible rollover distribution. See Notice 2002–3, 2002–1 C.B. 289, that contains a Safe Harbor Explanation that plan administrators may provide to recipients of eligible rollover distributions from employer plans in order to satisfy the notice requirement.*

Note: *See generally § 1.403(b)–6 of the Income Tax Regulations for rules relating to restrictions on distributions.*

Note: *If this Section 5 is adopted separately, the following definitions from Section 1 should also be adopted: Account, Account Balance, Beneficiary, Code, Disabled, Elective Deferral, Employer, Individual Agreement, Participant, Plan, Severance from Employment, and Vendor.*

Section 6
Rollovers to the Plan and Transfers

6.1 ***Eligible Rollover Contributions to the Plan.***

(a) ***Eligible Rollover Contributions***. To the extent provided in the Individual Agreements, an Employee who is a Participant who is entitled to receive an eligible rollover distribution from another eligible retirement plan may request to have all or a portion of the eligible rollover distribution paid to the Plan. Such rollover contributions shall be made in the form of cash only. The Vendor may require such documentation from the distributing plan as it deems necessary to effectuate the rollover in accordance with section 402 of the Code and to confirm that such plan is an eligible retirement plan within the meaning of section 402(c)(8)(B) of the Code. However, in no event does the Plan accept a rollover contribution from a Roth elective deferral account under an applicable retirement plan described in section 402A(e)(1) of the Code or a Roth IRA described in section 408A of the Code.

Note: *This provision does not permit rollovers to be accepted from a Roth elective deferral account or a Roth IRA because the Plan does not provide for designated Roth contributions.*

(b) ***Eligible Rollover Distribution***. For purposes of Section 6.1(a), an eligible rollover distribution means any distribution of all or any portion of a Participant's benefit under another eligible retirement plan, except that an eligible rollover distribution does not include (1) any installment payment for a period of 10 years or more, (2) any distribution made as a result of an unforeseeable emergency or other distribution which is made upon hardship of the employee, or (3) for any other distribution, the portion, if any, of the distribution that is a required minimum distribution under section 401(a)(9) of the Code. In addition, an eligible retirement plan means an individual retirement account described in section 408(a) of the Code, an individual retirement annuity described in section 408(b) of the Code, a qualified trust described in section 401(a) of the Code, an annuity plan described in section 403(a) or 403(b) of the Code, or an eligible governmental plan described in section 457(b) of the Code, that accepts the eligible rollover distribution.

(c) ***Separate Accounts***. The Vendor shall establish and maintain for the Participant a separate account for any eligible rollover distribution paid to the Plan.

6.2 ***Plan-to-Plan Transfers to the Plan***. (a) At the direction of the Employer, for a class of Employees who are participants or beneficiaries in another plan under section 403(b) of the Code, the Administrator may permit a transfer of assets to the Plan as provided in this Section 6.2. Such a transfer is permitted only if the other plan provides for the direct transfer of each person's entire interest therein to the Plan and the participant is an employee or former employee of the Employer. The Administrator and any Vendor accepting such transferred amounts may require that the transfer be in cash or other property acceptable to it. The Administrator or any Vendor accepting such transferred amounts may require such documentation from the other plan as it deems necessary to effectuate the transfer in accordance with § 1.403(b)–10(b)(3) of the Income Tax Regulations and to confirm that the other plan is a plan that satisfies section 403(b) of the Code.

(b) The amount so transferred shall be credited to the Participant's Account Balance, so that the Participant or Beneficiary whose assets are being transferred has an accumulated benefit immediately after the transfer at least equal to the accumulated benefit with respect to that Participant or Beneficiary immediately before the transfer.

(c) To the extent provided in the Individual Agreements holding such transferred amounts, the amount transferred shall be held, accounted for, administered and otherwise treated in the same manner as an Elective Deferral by the Participant under the Plan, except that (1) the Individual Agreement which holds any amount transferred to the Plan must provide that, to the extent any amount transferred is subject to any distribution restrictions required under section 403(b) of the Code, the Individual Agreement must impose restrictions on distributions to the Participant or Beneficiary whose assets are being transferred that are not less stringent than those imposed on the transferor plan and (2) the transferred amount shall not be considered an Elective Deferral under the Plan in determining the maximum deferral under Section 3.

Note: *This provision limits transfer to the plan to cases involving a class of participants whose entire benefit is being transferred, such as where employees are being transferred from another employer to employment with the employer maintaining this plan and the portion of the other plan held on their behalf is being merged into this plan. Plan-to-plan transfers are not required to be limited to such situations. See § 1.403(b)–10(b)(3) of the Income Tax Regulations for rules relating to plan-to-plan transfers among § 403(b) plans and, in the case of plans that are subject to ERISA, see also § 1.414(l)–1 of the Income Tax Regulations.*

6.3 ***Plan-to-Plan Transfers from the Plan***.

(a) At the direction of the Employer, the Administrator may permit a class of Participants and Beneficiaries to elect to have all or any portion of their Account Balance transferred to another plan that satisfies section 403(b) of the Code in accordance with § 1.403(b)–10(b)(3) of the Income Tax Regulations. A transfer is permitted under this Section 6.3(a) only if the Participants or Beneficiaries are employees or former employees of the employer (or the business of the employer) under the receiving plan and the other plan provides for the acceptance of plan-to-plan transfers with respect to the Participants and Beneficiaries and for each Participant and Beneficiary to have an amount deferred under the other plan immediately after the transfer at least equal to the amount transferred.

(b) The other plan must provide that, to the extent any amount transferred is subject to any distribution restrictions required under section 403(b) of the Code, the other plan shall impose restrictions on distributions to the Participant or Beneficiary whose assets are transferred that are not less stringent than those imposed under the Plan. In addition, if the transfer does not constitute a complete transfer of the Participant's or Beneficiary's interest in the Plan, the other plan shall treat the amount transferred as a continuation of a pro rata portion of the Participant's or Beneficiary's interest in the transferor plan (*e.g.*, a pro rata portion of the Participant's or Beneficiary's interest in any after-tax employee contributions).

(c) Upon the transfer of assets under this Section 6.3, the Plan's liability to pay benefits to the Participant or Beneficiary under this Plan shall be discharged to the extent of the amount so transferred for the Participant or Beneficiary. The Administrator may require such documentation from the receiving plan as it deems appropriate or necessary to comply with this Section 6.3 (for example, to confirm that the receiving plan satisfies section 403(b) of the Code and to assure that the transfer is permitted under the receiving plan) or to effectuate the transfer pursuant to § 1.403(b)–10(b)(3) of the Income Tax Regulations.

Note: *This provision limits transfer from the plan to cases involving a class of participants whose entire benefit is being transferred, such as where employees are being transferred from employment with the employer maintaining this plan to another employer and the portion of the plan held on their behalf is being merged into another plan. Plan-to-plan transfers are not required to be limited to such situations. See § 1.403(b)–10(b)(3) of the Income Tax Regulations for rules relating to plan-to-plan transfers among § 403(b) plans and, in the case of plans that are subject to ERISA, see also § 1.414(l)–1 of the Income Tax Regulations.*

6.4 ***Contract and Custodial Account Exchanges***. (a) A Participant or Beneficiary is permitted to change the investment of his or her Account Balance among the Vendors under the Plan, subject to the terms of the Individual Agreements. However, an investment change that includes an investment with a Vendor that is not eligible to receive contributions under Section 2 (referred to below as an exchange) is not permitted unless the conditions in paragraphs (b) through (d) of this Section 6.4 are satisfied.

(b) The Participant or Beneficiary must have an Account Balance immediately after the exchange that is at least equal to the Account Balance of that Participant or Beneficiary immediately before the exchange (taking into account the Account Balance of that Participant or Beneficiary under both section 403(b) contracts or custodial accounts immediately before the exchange).

(c) The Individual Agreement with the receiving Vendor has distribution restrictions with respect to the Participant that are not less stringent than those imposed on the investment being exchanged.

(d) The Employer enters into an agreement with the receiving Vendor for the other contract or custodial account under which the Employer and the Vendor will from time to time in the future provide each other with the following information:

(1) Information necessary for the resulting contract or custodial account, or any other contract or custodial accounts to which contributions have been made by the Employer, to satisfy section 403(b) of the Code, including the following: (i) the Employer providing information as to whether the Participant's employment with the Employer is continuing, and notifying the Vendor when the Participant has had a Severance from Employment (for purposes of the distribution restrictions in Section 5.1); (ii) the Vendor notifying the Employer of any hardship withdrawal under Section 5.5 if the withdrawal results in a 6-month suspension of the Participant's right to make Elective Deferrals under the Plan; and (iii) the Vendor providing information to the Employer or other Vendors concerning the Participant's or Beneficiary's section 403(b) contracts or custodial accounts or qualified employer plan benefits (to enable a Vendor to determine the amount of any plan loans and any rollover accounts that are available to the Participant under the Plan in order to satisfy the financial need under the hardship withdrawal rules of Section 5.5); and

(2) Information necessary in order for the resulting contract or custodial account and any other contract or custodial account to which contributions have been made for the Participant by the Employer to satisfy other tax requirements, including the following: (i) the amount of any plan loan that is outstanding to the Participant in order for a Vendor to determine whether an additional plan loan satisfies the loan limitations of Section 4.3, so that any such additional loan is not a deemed distribution under section 72(p)(1); and (ii) information concerning the Participant's or Beneficiary's after-tax employee contributions in order for a Vendor to determine the extent to which a distribution is includible in gross income.

(e) If any Vendor ceases to be eligible to receive Elective Deferrals under the Plan, the Employer will enter into an information sharing agreement as described in Section 6.4(d) to the extent the Employer's contract with the Vendor does not provide for the exchange of information described in Section 6.4(d)(1) and (2).

Note: *Section 6.4(a) through (d) are optional provisions for a plan that chooses to allow participants to exchange all or a portion of their account balance with vendors with respect to which the plan has no regular contact, i.e., insurance companies or mutual funds that do not receive regular contributions made for participants. Note also that additional information would be necessary in the case of an exchange involving a designated Roth account. See generally § 1.403(b)–10(b)(2) of the Income Tax Regulations for rules relating to exchanges of contracts.*

6.5 ***Permissive Service Credit Transfers.***

(a) If a Participant is also a participant in a tax-qualified defined benefit governmental plan (as defined in section 414(d) of the Code) that provides for the acceptance of plan-to-plan transfers with respect to the Participant, then the Participant may elect to have any portion of the Participant's Account Balance transferred to the defined benefit governmental plan. A transfer under this Section 6.5(a) may be made before the Participant has had a Severance from Employment.

(b) A transfer may be made under Section 6.5(a) only if the transfer is either for the purchase of permissive service credit (as defined in section 415(n)(3)(A) of the Code) under the receiving defined benefit governmental plan or a repayment to which section 415 of the Code does not apply by reason of section 415(k)(3) of the Code.

(c) In addition, if a plan-to-plan transfer does not constitute a complete transfer of the Participant's or Beneficiary's interest in the transferor plan, the Plan shall treat the amount transferred as a continuation of a pro rata portion of the Participant's or Beneficiary's interest in the transferor plan (*e.g.*, a pro rata portion of the Participant's or Beneficiary's interest in any after-tax employee contributions).

Note: *See § 1.403(b)–10(b)(4) of the Income Tax Regulations for rules relating to transfers for permissive service credit.*

Note: *If this Section 6 is adopted separately, the following definitions from Section 1 should also be adopted: Administrator, Account Balance, Beneficiary, Code, Elective Deferral, Employee, Employer, Individual Agreement, Participant, Plan, Severance from Employment, and Vendor.*

Section 7
Investment of Contributions

7.1 ***Manner of Investment***. All Elective Deferrals or other amounts contributed to the Plan, all property and rights purchased with such amounts under the Funding Vehicles, and all income attributable to such amounts, property, or rights shall be held and invested in one or more Annuity Contracts or Custodial Accounts. Each Custodial Account shall provide for it to be impossible, prior to the satisfaction of all liabilities with respect to Participants and their Beneficiaries, for any part of the assets and income of the Custodial Account to be used for, or diverted to, purposes other than for the exclusive benefit of Participants and their Beneficiaries.

7.2 ***Investment of Contributions***. Each Participant or Beneficiary shall direct the investment of his or her Account among the investment options available under the Annuity Contract or Custodial Account in accordance with the terms of the Individual Agreements. Transfers among Annuity Contracts and Custodial Accounts may be made to the extent provided in the Individual Agreements and permitted under applicable Income Tax Regulations.

Note: *See generally § 1.403(b)–8 of the Income Tax Regulations for rules relating to funding.*

Note: *If this Section 7 is adopted separately, the following definitions from Section 1 should also be adopted: Annuity Contract, Beneficiary, Custodial Account, Individual Agreement, Elective Deferral, Participant, and Plan.*

7.3 ***Current and Former Vendors***. The Administrator shall maintain a list of all Vendors under the Plan. Such list is hereby incorporated as part of the Plan. Each Vendor and the Administrator shall exchange such information as may be necessary to satisfy section 403(b) of the Code or other requirements of applicable law. In the case of a Vendor which is not eligible to receive Elective Deferrals under the Plan (including a Vendor which has ceased to be a Vendor eligible to receive Elective Deferrals under the Plan and a Vendor holding assets under the Plan in accordance with Section 6.2 or 6.4), the Employer shall keep the Vendor informed of the name and contact information of the Administrator in order to coordinate information necessary to satisfy section 403(b) of the Code or other requirements of applicable law.

Section 8
Amendment and Plan Termination

8.1 ***Termination of Contributions***. The Employer has adopted the Plan with the intention and expectation that contributions will be continued indefinitely. However, the Employer has no obligation or liability whatsoever to maintain the Plan for any length of time and may discontinue contributions under the Plan at any time without any liability hereunder for any such discontinuance.

8.2 ***Amendment and Termination***. The Employer reserves the authority to amend or terminate this Plan at any time.

8.3 ***Distribution upon Termination of the Plan***. The Employer may provide that, in connection with a termination of the Plan and subject to any restrictions contained in the Individual Agreements, all Accounts will be distributed, provided that the Employer and any Related Employer on the date of termination do not make contributions to an alternative section 403(b) contract that is not part of the Plan during the period beginning on the date of plan termination and ending 12 months after the distribution of all assets from the Plan, except as permitted by the Income Tax Regulations.

Note: *See generally § 1.403(b)–10(a) of the Income Tax Regulations for rules relating to discontinuance of contributions and plan termination.*

Note: *If this Section 8 is adopted separately, the following definitions from Section 1 should also be adopted: Account, Employer, Individual Agreement, Plan, and Related Employer.*

Section 9
Miscellaneous

9.1 ***Non-Assignability.*** Except as provided in Section 9.2 and 9.3, the interests of each Participant or Beneficiary under the Plan are not subject to the claims of the Participant's or Beneficiary's creditors; and neither the Participant nor any Beneficiary shall have any right to sell, assign, transfer, or otherwise convey the right to receive any payments hereunder or any interest under the Plan, which payments and interest are expressly declared to be non-assignable and non-transferable.

Note: *The anti-alienation rules of section 401(a)(13) of the Code generally do not apply to § 403(b) plans of public schools, but the parallel rule at section 206(d) of ERISA applies to plans that are subject to ERISA.*

9.2 ***Domestic Relation Orders.*** Notwithstanding Section 9.1, if a judgment, decree or order (including approval of a property settlement agreement) that relates to the provision of child support, alimony payments, or the marital property rights of a spouse or former spouse, child, or other dependent of a Participant is made pursuant to the domestic relations law of any State ("domestic relations order"), then the amount of the Participant's Account Balance shall be paid in the manner and to the person or persons so directed in the domestic relations order. Such payment shall be made without regard to whether the Participant is eligible for a distribution of benefits under the Plan. The Administrator shall establish reasonable procedures for determining the status of any such decree or order and for effectuating distribution pursuant to the domestic relations order.

Note: *Section 9.2 is specifically written for use by a State or local government maintaining a § 403(b) plan for its employees who perform services for a public school and, if used by a § 501(c)(3) employer, must be revised to be limited to cases in which the domestic relations order is "qualified" under § 414(p) of the Code.*

Note: *See generally § 414(p) of the Code and § 1.403(b)–10(c) of the Income Tax Regulations for rules regarding domestic relations orders.*

9.3 ***IRS Levy.*** Notwithstanding Section 9.1, the Administrator may pay from a Participant's or Beneficiary's Account Balance the amount that the Administrator finds is lawfully demanded under a levy issued by the Internal Revenue Service with respect to that Participant or Beneficiary or is sought to be collected by the United States Government under a judgment resulting from an unpaid tax assessment against the Participant or Beneficiary.

9.4 ***Tax Withholding***. Contributions to the Plan are subject to applicable employment taxes (including, if applicable, Federal Insurance Contributions Act (FICA) taxes with respect to Elective Deferrals, which constitute wages under section 3121 of the Code). Any benefit payment made under the Plan is subject to applicable income tax withholding requirements (including section 3401 of the Code and the Treasury Regulations thereunder). A payee shall provide such information as the Administrator may need to satisfy income tax withholding obligations, and any other information that may be required by guidance issued under the Code.

9.5 ***Payments to Minors and Incompetents.*** If a Participant or Beneficiary entitled to receive any benefits hereunder is a minor or is adjudged to be legally incapable of giving valid receipt and discharge for such benefits, or is deemed so by the Administrator, benefits will be paid to such person as the Administrator may designate for the benefit of such Participant or Beneficiary. Such payments shall be considered a payment to such Participant or Beneficiary and shall, to the extent made, be deemed a complete discharge of any liability for such payments under the Plan.

9.6 ***Mistaken Contributions.*** If any contribution (or any portion of a contribution) is made to the Plan by a good faith mistake of fact, then within one year after the payment of the contribution, and upon receipt in good order of a proper request approved by the Administrator, the amount of the mistaken contribution (adjusted for any income or loss in value, if any, allocable thereto) shall be returned directly to the Participant or, to the extent required or permitted by the Administrator, to the Employer.

9.7 ***Procedure When Distributee Cannot Be Located.*** The Administrator shall make all reasonable attempts to determine the identity and address of a Participant or a Participant's Beneficiary entitled to benefits under the Plan. For this purpose, a reasonable attempt means (a) the mailing by certified mail of a notice to the last known address shown on [INSERT NAME OF THE EMPLOYER]'s or the Administrator's records, (b) notification sent to the Social Security Administration or the Pension Benefit Guaranty Corporation (under their program to identify payees under retirement plans), and (c) the payee has not responded within 6 months. If the Administrator is unable to locate such a person entitled to benefits hereunder, or if there has been no claim made for such benefits, the funding vehicle shall continue to hold the benefits due such person.

9.8 ***Incorporation of Individual Agreements***. The Plan, together with the Individual Agreements, is intended to satisfy the requirements of section 403(b) of the Code and the Income Tax Regulations thereunder. Terms and conditions of the Individual Agreements are hereby incorporated by reference into the Plan, excluding those terms that are inconsistent with the Plan or section 403(b) of the Code.

9.9 ***Governing Law***. The Plan will be construed, administered and enforced according to the Code and the laws of the State in which the Employer has its principal place of business.

9.10 ***Headings***. Headings of the Plan have been inserted for convenience of reference only and are to be ignored in any construction of the provisions hereof.

9.11 ***Gender***. Pronouns used in the Plan in the masculine or feminine gender include both genders unless the context clearly indicates otherwise.

IN WITNESS WHEREOF, the Employer has caused this Plan to be executed this ____ day of ____, ____.

Employer: ______________________________

By: ______________________________

Title: ______________________________

Date signed: ______________________________

Effective Date of the Plan: ______________

Note: *The provisions in Section 9 are optional provisions that are not required to be adopted.*

Note: *If this Section 9 is adopted separately, the following definitions from Section 1 should also be adopted: Administrator, Account Balance, Beneficiary, Employer, Individual Agreement, Participant, and Plan.*

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Update and Revision of Sections 1.381(c)(4)–1 and 1.381(c)(5)–1

REG–151884–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance under sections 381(c)(4) and (c)(5) of the Internal Revenue Code (Code) relating to the accounting method or combination of methods, including the inventory method, to use after certain corporate reorganizations and tax-free liquidations. These proposed regulations clarify and simplify the existing regulations under sections 381(c)(4) and (c)(5). The regulations affect corporations that acquire the assets of other corporations in transactions described in section 381(a).

DATES: Written or electronic comments and requests for a public hearing must be received by February 14, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–151884–03), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–151884–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–151884–03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Cheryl Oseekey at (202) 622–4970; concerning submissions of comments and requests for a hearing, Kelly Banks at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Overview

Section 381 of the Code was enacted in 1954 to provide statutory authority for determining the carryover of certain tax attributes, including accounting methods, in certain corporate reorganizations and tax-free liquidations. Regulations implementing section 381(c)(4) were issued on August 5, 1964 (T.D. 6750, 1964–2 C.B. 96 [29 FR 11263]). On August 23, 1972, the IRS proposed to revise these regulations (37 FR 16947). On December 23, 1998, the IRS withdrew the regulations that had been proposed in 1972 (REG–116099–98, 1999–2 C.B. 822 [63 FR 71047]). Regulations implementing section 381(c)(5) were issued on January 15, 1975 (40 FR 2684).

Section 1.381(c)(4)–1 generally provides that after a section 381(a) transaction, the accounting method or combination of methods used by the parties to the section 381(a) transaction prior to the transaction will continue. However, when the accounting methods used prior to the section 381(a) transaction cannot continue to be used after the transaction, §1.381(c)(4)–1 identifies the accounting method(s) to use after the transaction. Section 1.381(c)(5)–1 provides similar rules regarding inventory accounting methods.

The IRS and the Treasury Department are aware that the current regulations are inconsistent in the treatment of adjustments for inventory methods and for other accounting methods, and that there is confusion regarding the appropriate procedure for making accounting method changes required by section 381. In a notice of proposed rulemaking (REG–142605–02, 2003–1 C.B. 1010 [68 FR 25310]) issued on May 12, 2003, regarding sections 263A and 448, the IRS and the Treasury Department indicated that guidance regarding the accounting method(s) to be used after a section 381(a) transaction was contemplated. This notice of proposed rulemaking provides that guidance.

This notice of proposed rulemaking generally continues many of the provisions of the regulations originally issued in 1964 and 1975 regarding the accounting method or combination of methods to be used by the corporation that acquires the assets of another corporation in a section 381(a) transaction. However, the following changes to these regulations are proposed.

Consistency Between Sections 381(c)(4) and (c)(5)

Under the current regulations, there are several inconsistencies between the rules that apply to accounting method changes made pursuant to section 381(c)(4) and those made under section 381(c)(5). The proposed regulations generally make the rules that apply to accounting method changes made pursuant to section 381(c)(4) consistent with the rules that apply to changes made under section 381(c)(5).

Determining the Method to be used after the Section 381(a) Transaction

In general, the current regulations under both sections 381(c)(4) and (c)(5) provide that the accounting method to be used after a section 381(a) transaction by the party that survives the reorganization or liquidation (acquiring corporation) will depend on whether (1) The parties to the section 381(a) transaction used (or did not use) the same accounting method on the date of the section 381(a) transaction, and (2) The businesses of the parties to the section 381(a) transaction are combined after the transaction by the party that survives the transaction. If different methods are used and the combined corporations are operated as a single trade or business after the section 381(a) transaction, then the principal and special method (including the inventory method) rules apply.

The parties to the section 381(a) transaction determine the principal method by applying various tests under the regulations. The applicable test depends on whether the method under consideration is the overall accounting method, the method for a particular type of goods for which the Code or regulations provide a special method or methods, or an inventory

method. The rules under the current regulations also address situations in which there is no principal method, or the principal method does not clearly reflect income. Currently, the regulations provide that if there is no principal method after applying the appropriate test or if that method is impermissible, the Commissioner shall select a suitable accounting method to use after the transaction.

The IRS and the Treasury Department believe that the various tests in the regulations and the need for the Commissioner in some situations to select a suitable accounting method to be used after the transaction have caused confusion and have led to controversies between taxpayers and the IRS. In order to eliminate the confusion and uncertainty and provide simplicity and uniformity, the IRS and the Treasury Department propose to provide rules that are similar to the current regulations but have a default rule to determine the principal method.

The proposed regulations generally provide under both sections 381(c)(4) and (c)(5) that the accounting method to be used after a section 381(a) transaction by the acquiring corporation will depend on whether (1) The businesses of the parties to the section 381(a) transaction are combined after the transaction by the acquiring corporation, and (2) The method is permissible. As under the current regulations, if the trades or businesses of the parties to the section 381(a) transaction are operated as separate trades or businesses after the section 381(a) transaction, an accounting method used by the parties prior to the section 381(a) transaction carries over and is used by the acquiring corporation provided the method is permissible (carryover method). If the trades or businesses of the parties to the section 381(a) transaction are not operated as separate trades or businesses after the section 381(a) transaction, then the acquiring corporation must determine and use the principal method.

The proposed regulations provide a general rule that the principal method generally is the accounting method used by the acquiring corporation prior to the section 381(a) transaction. However, there are two exceptions. First, if the acquiring corporation does not have an accounting method for a particular item or type of goods, the principal method is the accounting method for the item or type of goods used by the distributor or transferor corporation prior to the section 381(a) transaction. Second, if the distributor or transferor corporation is larger than the acquiring corporation, the principal methods for the overall accounting method and for the accounting method for a particular item or type of goods are the methods used by the distributor or transferor corporation prior to the section 381(a) transaction. The principal method continues to be determined separately for the overall accounting method and for any special accounting methods, such as an accounting method used for a long-term contract.

Under the proposed regulations, whether the distributor or transferor corporation is larger than the acquiring corporation is determined using the test in §1.381(c)(4)–1 of the current regulations for determining the overall principal method for methods other than inventory. Therefore, the parties to the section 381(a) transaction will compare their relative sizes in terms of total asset bases and gross receipts for both the overall accounting method and for special accounting methods. For inventory, whether the distributor or transferor corporation is larger than the acquiring corporation will be determined based on the value of the inventory using a test similar to the test in §1.381(c)(5)–1 of the current regulations. The principal method is the inventory method used by the party with the largest fair market value of a particular type of goods. The regulations provide a simplified election that allows the acquiring corporation to apply the principal method test by comparing the value of the entire inventories of the parties to the section 381(a) transaction rather than the value of each particular type of goods.

Under the proposed regulations, if the carryover method or principal method is an impermissible method, the acquiring corporation generally must file a request to change to a permissible accounting method. However, if the carryover method is impermissible solely because only a single accounting method with respect to a particular item may be used by the acquiring corporation on the date of the section 381(a) transaction regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation must use the principal method as determined under §1.381(c)(4)–1(c) of the proposed regulations.

All parties to a section 381(a) transaction may request permission to change their accounting methods for the taxable year in which the transaction occurs or is expected to occur under section 446(e). However, the acquiring corporation need not secure the Commissioner's consent to continue a carryover method or use the principal method.

Additionally, there is confusion under the current regulations as to whether an accounting method is established immediately upon use of a carryover method or principal method if the method is impermissible, and as to the appropriate remedy if an acquiring corporation discovers after the deadline for filing a request to change an accounting method for the year of the section 381(a) transaction that the carryover method or principal method is an impermissible method. The proposed regulations make it clear that every accounting method, whether it is a carryover method or a principal method, and whether the method is a permissible or impermissible method, is an established accounting method. Therefore, if an acquiring corporation discovers after the deadline for filing a request to change an accounting method for the year of the section 381(a) transaction that it is using an impermissible method, the acquiring corporation must file for an accounting method change to a permissible accounting method for the taxable year following the section 381(a) transaction.

Determining Adjustments Arising from a Change in an Accounting Method under Sections 381(c)(4) and (c)(5)

Under the current regulations in §1.381(c)(4)–1, once a principal method is determined, any party to the section 381(a) transaction that is required to change its accounting method to the principal method must compute the adjustment necessary to reflect the change by determining the difference between its tax liability as reflected on its actual return computed using its old accounting method, and the tax liability reflected on a hypothetical federal income tax return using the new accounting method. This adjustment is computed as if, on the date of the section 381(a) transaction, each changing corporation

initiates an accounting method change. If there is an increase or decrease in tax liability, the acquiring corporation takes into account the hypothetical increase or decrease in tax in the taxable year that includes the date of the section 381(a) transaction.

The procedures are different for inventory under the current regulations in §1.381(c)(5)–1. In lieu of the acquiring corporation taking into account the hypothetical increase or decrease in tax in the taxable year that includes the date of the section 381(a) transaction, the acquiring corporation takes the increase or decrease in income attributable to the accounting method change directly into account.

The IRS and the Treasury Department believe that the procedures for implementing changes to a principal method under the current regulations have been inconsistently applied and are another source of confusion. The proposed regulations modify §1.381(c)(4)–1 and generally apply the adjustment methodology used under section 446(e) and §1.381(c)(5)–1 of the current regulations. The proposed regulations generally make accounting method changes to a principal method and the resulting section 481(a) adjustment, if any, procedurally consistent with accounting method changes made pursuant to section 446(e). Accordingly, the acquiring corporation computes the section 481(a) adjustment necessary to reflect the accounting method change, if any, as if it had initiated an accounting method change for the trade or business required to implement the principal method. The acquiring corporation takes into account the appropriate amount of the section 481(a) adjustment, if any, computed as of the date of the section 381(a) transaction, from the accounting method change as an increase or decrease to its taxable income on the date of the section 381(a) transaction.

Furthermore, to simplify the procedures under section 381(a) for accounting method changes, the proposed regulations provide that the rules governing accounting method changes under section 446(e) apply to determine (1) Whether the section 381(a) accounting method change is implemented with a section 481(a) adjustment or on a cut-off basis, (2) The computation of the section 481(a) adjustment, and (3) The appropriate period of taxable years over which the adjustment is included in taxable income. These rules are contained in applicable administrative published procedures that govern voluntary accounting method changes under section 446(e). (See, for example, Rev. Proc. 2002–9, 2002–1 C.B. 327, (see §601.601(d)(2)(ii)(*b*) of this chapter), as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, (see §601.601(d)(2)(ii)(*b*) of this chapter), and amplified, clarified and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432, and Rev. Proc. 97–27, 1997–1 C.B. 680, (see §601.601(d)(2)(ii)(*b*) of this chapter), as modified and amplified by Rev. Proc. 2002–19, as amplified and clarified by Rev. Proc. 2002–54). For example, if the current administrative procedures allow a section 481(a) adjustment to be taken into account over a period of four years for a particular accounting method change, an acquiring corporation will take into account one-fourth of the section 481(a) adjustment in the taxable year that includes the section 381(a) transaction, and one-fourth of the section 481(a) adjustment in each of the subsequent three years.

Time and Manner of Requesting Permission to Change an Accounting Method under §1.381(c)(4)–1 or §1.381(c)(5)–1

Under the current regulations, if the acquiring corporation cannot use a principal method because it is impermissible, that is, it does not clearly reflect income or it conflicts with a closing agreement, or the acquiring corporation does not want to use the principal method even though it is permissible, there is confusion as to the manner in which a taxpayer requests the Commissioner's permission to use a different accounting method. Specifically, it is unclear whether an acquiring corporation may file a Form 3115, *Application for Change in Accounting Method*, to request the Commissioner's permission or whether the acquiring corporation must file a request for a private letter ruling. The proposed regulations make it clear that a taxpayer must request an accounting method change consistent with the manner in which accounting method changes are requested pursuant to section 446(e), that is, on a Form 3115.

The regulations under section 446(e) currently allow taxpayers to request an accounting method change at any time during the taxable year. See §1.446–1(e)(3)(i). Under §§1.381(c)(4)–1(d) and 1.381(c)(5)–1(d) of the current regulations, the time for filing a request for an accounting method change is inconsistent with the section 446(e) regulations. Although the times for filing under these two regulations were consistent when the regulations were initially published, the section 446(e) regulations were subsequently amended without making conforming changes to §§1.381(c)(4)–1(d) and 1.381(c)(5)–1(d) of the current regulations. This inconsistency also has caused confusion. Rev. Proc. 2005–63, 2005–2 C.B. 491, (see §601.601(d)(2)(ii)(*b*) of this chapter) was issued to address the problem. The revenue procedure extends the time to file a request to change an accounting method to the later of (1) The last day of the taxable year in which the distribution or transfer occurred, or (2) The earlier of (a) the day that is 180 days after the section 381(a) transaction date, or (b) the day on which the acquiring corporation files its tax return for the taxable year in which the distribution or transfer occurred.

The proposed regulations generally incorporate the time provided in Rev. Proc. 2005–63 for requesting the Commissioner's consent to change an accounting method. The IRS and the Treasury Department intend by this revision generally to conform the due dates for requesting an accounting method change under sections 381(c)(4) and (c)(5) to the due dates for requesting other accounting method changes under section 446(e), while providing sufficient time to request the Commissioner's consent if the section 381(a) transaction occurs at or near the end of a taxable year.

Changing Accounting Methods in the Taxable Year of the Section 381(a) Transaction

The existing regulations under sections 381(c)(4) and (c)(5) require certain adjustments attributable to an accounting method change to be taken into account entirely in one taxable year. The adjustment required of the acquiring corporation under the existing section 381(c)(4) regulations is to take into account the hypo-

thetical tax increase due to the accounting method change rather than a section 481(a) adjustment. The administrative procedures applicable to voluntary accounting method changes historically have required a section 481(a) adjustment to be taken into account over a period of taxable years. This discrepancy in when the adjustments are taken into account produced an incentive for taxpayers to request a voluntary accounting method change in the year in which the section 381(a) transaction occurred for changes that would result in a positive adjustment while making changes that would result in a negative adjustment under the rules in §1.381(c)(4)–1 or §1.381(c)(5)–1 of the current regulations. The IRS generally declined to entertain requests for an accounting method change that otherwise would be effected pursuant to sections 381(c)(4) and (c)(5). More recently, however, the administrative procedures that apply to voluntary accounting method changes have provided for taking positive section 481(a) adjustments into account over a period of taxable years while allowing negative section 481(a) adjustments to be taken into account in the year in which the method change is effected, which lessens the incentive to make an accounting method change under section 446(e) in lieu of section 381(a).

Generally, the proposed regulations provide that the acquiring corporation will be permitted to request an accounting method change for the taxable year in which the section 381(a) transaction occurs. The proposed regulations also provide that the other parties to a section 381(a) transaction will be allowed to request accounting method changes for the taxable year that ends with the section 381(a) transaction. For trades or businesses that will not operate as separate trades or businesses after the section 381(a) transaction, an accounting method change will be granted only if the requested method is the method that will continue to be used after the section 381(a) transaction. For example, an acquiring corporation will be granted permission to change an accounting method only if the proposed method will be the principal method on the date of the section 381(a) transaction. The IRS generally will not grant an accounting method change to a distributor or transferor corporation for the taxable year that ends with the section 381(a) transaction if that method must change to a different method under the principal method rules of §§1.381(c)(4)–1(c) and 1.381(c)(5)–1(c) of the proposed regulations. Similarly, the IRS generally will not grant an accounting method change to an acquiring corporation in the taxable year that includes the section 381(a) transaction if that method must change to a different method under the principal method rules of §§1.381(c)(4)–1(c) and 1.381(c)(5)–1(c) of the proposed regulations. If and when the proposed regulations are finalized, the IRS and the Treasury Department intend to make changes to the administrative procedures applicable to voluntary accounting methods to generally allow changes during the year of a section 381(a) transaction as previously described and will change relevant terms and conditions, as needed, particularly for taxpayers who are under exam or in appeals.

Audit Protection

Changes to the principal method under §§1.381(c)(4)–1 and 1.381(c)(5)–1 of the current regulations are made without audit protection. The IRS and the Treasury Department believe that audit protection is not warranted when either the carryover method or principal method, as applicable, is used in the context of voluntary compliance under sections 381(c)(4) and (c)(5). Unlike accounting method changes under section 446(e) for which a taxpayer must disclose its use of an improper accounting method as part of the accounting method change process, changes to a principal method pursuant to §§1.381(c)(4)–1 and 1.381(c)(5)–1 of the current regulations are made by the taxpayer on the tax return without disclosing the change on a Form 3115, *Application for Change in Accounting Method*.

The IRS and the Treasury Department, however, believe that audit protection is warranted when an accounting method other than the carryover method or principal method is used in the context of voluntary compliance under sections 381(c)(4) and (c)(5). Under the proposed regulations, a taxpayer using an improper accounting method may request permission to change the method at any time before the end of its taxable year. Thus, if the acquiring corporation is using an improper accounting method or would be required to use an improper accounting method because of the application of §1.381(c)(4)–1 or §1.381(c)(5)–1 of the proposed regulations, it can request consent to change to a proper accounting method. That change will be accorded the usual audit protection procedures provided in guidance issued under section 446(e) for the requested change. Similarly, if another party to the section 381(a) transaction is using an improper accounting method, it may request consent to change to a proper accounting method at any time prior to the section 381(a) transaction. That change also will be accorded the usual audit protection procedures provided in guidance issued under section 446(e) for the requested change.

Proposed Effective/Applicability Date

These regulations are proposed to apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after the date these regulations are published as final regulations in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Although there is a lack of available data regarding the extent to which small entities engage in the corporate reorganizations and tax-free liquidations described in section 381(a), this certification is based on the belief of the IRS and the Treasury Department that these transactions generally involve larger entities. Notwithstanding this certification that only large entities are affected, these proposed regulations will not have a significant economic impact on large or small taxpayers. These proposed regulations will reduce burden on taxpayers by clarifying existing rules and simplifying the procedures for requesting changes in accounting methods to methods other than the carryover or principal methods. Additionally, these proposed regulations make

the implementation rules more consistent with the general rules for changes in accounting methods. Therefore, because these proposed regulations would generally clarify and simplify existing rules, these regulations will not have a significant economic impact on a substantial number of small entities. The IRS and the Treasury Department specifically solicit comment from any party, particularly affected small entities, on the accuracy of this certification. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department want to provide clear, consistent, and administrable rules that will reduce the uncertainty and controversy in this area. Thus, the IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. Topics on which comments are requested include (1) In determining the relative sizes of the parties to a section 381(a) transaction, is it appropriate to calculate the gross receipts for a representative period by examining the gross receipts that are properly recognized under the acquiring corporation's and the distributor or transferor corporation's accounting method used for that period for federal income tax purposes, and (2) For a taxpayer using the last-in, first-out (LIFO) inventory method, should the principal method be applied at the level of each particular type of goods, or to pools of goods? All comments will be made available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Cheryl Oseekey, Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.381(c)(4)–1 also issued under 26 U.S.C. 381(c)(4). * * *

Section 1.381(c)(5)–1 also issued under 26 U.S.C. 381(c)(5). * * *

Par. 2. In §1.381(a)–1, paragraph (b)(1)(i) is revised and paragraph (e) is added to read as follows:

§1.381(a)–1 General rule relating to carryovers in certain corporate acquisitions.

* * * * *

(b) * * *

(1) * * * (i) The complete liquidation of a subsidiary corporation upon which no gain or loss is recognized in accordance with the provisions of section 332;

* * * * *

(e) *Effective/applicability date*. The rules of paragraph (b)(1)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 3. Section 1.381(c)(4)–1 is revised to read as follows:

§1.381(c)(4)–1 Accounting method.

(a) *Introduction*—(1) *Purpose*. This section provides guidance regarding the accounting method or combination of methods (other than inventory and depreciation accounting methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(4) apply and how to implement any associated accounting method changes. See §1.381(c)(5)–1 for guidance regarding the inventory accounting methods an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(5) apply. See §1.381(c)(6)–1 for guidance regarding the depreciation accounting methods an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(6) apply.

(2) *Carryover requirement*—(i) *In general*. In a transaction to which section 381(a) applies, if an acquiring corporation operates the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, then the acquiring corporation generally must use the same accounting method(s) used by the distributor or transferor corporation(s) on the date of distribution or transfer for the acquired trade or business (carryover method). If an acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, then the acquiring corporation must use a principal method as determined under paragraph (c) of this section and must take into account any section 481(a) adjustment, if applicable, as required under paragraph (d)(1) of this section. The acquiring corporation need not secure the Commissioner's consent to continue or to use a permissible carryover method or principal method.

(ii) *Carryover method or principal method not permissible*. In general, if a carryover method or principal method is an impermissible accounting method, the acquiring corporation must secure the Commissioner's consent to change to a different accounting method as provided in paragraph (d)(2) of this section. If, however, a carryover method is impermissible solely because only a single accounting method with respect to a particular item may be used by the acquiring corporation after the date of the section 381(a) transaction regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation

must use a principal method as determined under paragraph (c) of this section.

(iii) *Voluntary change*. All parties to a section 381(a) transaction may request permission under section 446(e) to change an accounting method for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate trades or businesses after the section 381(a) transaction, an accounting method change will be granted only if the requested method is the method that the acquiring corporation must use after the date of the distribution or transfer in the taxable year that includes the section 381(a) transaction. The time and manner of obtaining the Commissioner's consent to change to a different accounting method is described in paragraph (d)(2) of this section.

(iv) *Examples*. The following examples illustrate the rules of this paragraph (a):

Example 1. Separate and distinct trades or businesses after the date of the distribution or transfer—(i) *Facts*. X Corporation operates an employment agency that uses the overall cash receipts and disbursements accounting method. T Corporation operates an educational institution that uses an overall accrual method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation operates the employment agency and educational institution as separate and distinct trades or businesses after the date of the section 381(a) transaction.

(ii) *Conclusion*. After the section 381(a) transaction, X Corporation will use the cash receipts and disbursements method for the employment agency and an accrual method for the educational institution. X Corporation need not secure the Commissioner's consent to continue either accounting method.

Example 2. Carryover of special accounting method—(i) *Facts*. X Corporation provides personal grooming consulting and T Corporation provides weight management consulting. Both X Corporation and T Corporation use an overall accrual method. X Corporation acquires all of the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation operates the personal grooming and weight management consulting businesses as separate and distinct trades or businesses after the date of the section 381(a) transaction. X Corporation has made an election to use the recurring item exception under §1.461–4(h). T Corporation has not.

(ii) *Conclusion*. After the section 381(a) transaction, X Corporation will use an overall accrual method for both the personal grooming consulting business and the weight management consulting business. X Corporation must continue to use the recurring item exception under §1.461–4(h) for the personal grooming consulting business. X Corporation need not secure the Commissioner's consent to continue its overall accrual method and the recurring item exception under §1.461–4(h) for the personal grooming consulting business.

Example 3. One accounting method allowed—(i) *Facts*. X Corporation is an engineering firm that uses the overall cash receipts and disbursements accounting method and has elected under section 171 to amortize bond premium with respect to its taxable bonds acquired at a premium. T Corporation is a manufacturer that uses an overall accrual accounting method and has not made a section 171 election to amortize bond premium with respect to its taxable bonds acquired at a premium. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation operates the engineering firm and manufacturing operations as separate and distinct trades or businesses after the date of the section 381(a) transaction.

(ii) *Conclusion*. After the section 381(a) transaction, X Corporation will use the cash receipts and disbursements method for the engineering firm and an overall accrual method for the manufacturing operations. X Corporation may not continue separate accounting methods for amortizable bond premium, notwithstanding that it has two separate and district trades or businesses, because a taxpayer is permitted only one accounting method for amortizable bond premium. For both trades or businesses, X Corporation must use the principal method for bond premium as determined under paragraph (c) of this section. X Corporation will make the necessary changes to this principal method using the procedures described in paragraph (d)(1) of this section. Further, if the principal method is not to amortize bond premium, X Corporation may make an election to amortize bond premium to the extent permitted by section 171. See paragraph (e)(2) of this section.

Example 4. Voluntary change—(i) *Facts*. The facts are the same as in *Example 1* except that X Corporation wants to cease using an overall accrual method for the educational institution and change to the cash receipts and disbursements method.

(ii) *Conclusion*. X Corporation must secure the Commissioner's consent to use the cash receipts and disbursements method for the educational institution by filing a Form 3115, *Application for Change in Accounting Method*, as described in paragraph (d)(2) of this section.

(b) *Definitions*—(1) *Accounting method* has the same meaning as provided in section 446 and any applicable regulations.

(2) *Special accounting method* is a method expressly permitted or required by the Code, Income Tax Regulations, or administrative guidance published in the Internal Revenue Bulletin that deviates from the normal application of the cash receipts and disbursements method or an accrual method. For example, the installment method under section 453 and the mark-to-market method under section 475 are special accounting methods. See §1.446–1(c)(1)(iii).

(3) *Principal method* is an accounting method that is determined under paragraph (c) of this section.

(4) *Adopting an accounting method* has the same meaning as provided in §1.446–1(e)(1).

(5) *Changing an accounting method* has the same meaning as provided in §1.446–1(e)(2).

(6) *Acquiring corporation* has the same meaning as provided in §1.381(a)–1(b)(2).

(7) *Distributor corporation* means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(8) *Transferor corporation* means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (C), or (F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (G), provided the requirements of section 354(b) are met.

(9) *Parties to the section 381(a) transaction* means the acquiring corporation and the distributor or transferor corporation(s) that participate in a transaction to which section 381(a) applies.

(10) *Date of distribution or transfer* has the same meaning as provided in section 381(b)(2) and §1.381(b)–(1)(b).

(11) *Separate and distinct trades or businesses* has the same meaning as provided in §1.446–1(d).

(12) *Gross receipts* means all the receipts in the appropriate period that must be recognized under the acquiring corporation's and the distributor or transferor corporation's accounting method actually used in that period (determined without regard to this section) for federal income tax purposes. For example, gross receipts includes income from investments, amounts received for services, rents, total sales (net of returns and allowances) and interest.

(13) *Audit protection* means that the IRS will not require the corporation required to change its accounting method under this section to change its method for the same item for a taxable year prior to the taxable year of the section 381(a) transaction requiring the change in accounting method.

(14) *Section 481(a) adjustment* means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of a taxpayer is computed under an accounting method different from the method used to compute taxable income for the preceding taxable year.

(15) *Cut-off basis* means an accounting method change made without a section 481(a) adjustment and under which only the items arising on or after the date the accounting method change is made are accounted for under the new accounting method.

(16) *Adjustment period* means the number of taxable years for taking into account the section 481(a) adjustment required as a result of an accounting method change.

(c) *Principal method*—(1) *In general.* The principal methods for the overall accounting method and for all accounting methods for particular items generally are the accounting methods used by the acquiring corporation immediately prior to the date of the section 381(a) transaction (acquiring corporation's carryover method(s)). If, however, the acquiring corporation does not have an accounting method for a particular item or if the distributor or transferor corporation is larger, the principal methods are the methods used by the distributor or transferor corporation immediately prior to the date of the transaction (distributor or transferor corporation's carryover method). The distributor or transferor corporation is larger if the—

(i) Adjusted bases of the distributor or transferor corporation's assets (determined under section 1011 and the regulations thereunder) exceed the adjusted bases of the acquiring corporation's assets immediately prior to the date of distribution or transfer, and

(ii) The distributor or transferor corporation's gross receipts for a representative period (generally the most recent period of 12 consecutive calendar months ending on the date of distribution or transfer) exceed the acquiring corporation's gross receipts for the same period.

(2) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. Principal method is the acquiring corporation's carryover method—(i) *Facts.* X Corporation and T Corporation operate employment agencies. X Corporation uses the overall cash receipts and disbursements accounting method while T Corporation uses an overall accrual method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. The adjusted bases of X Corporation's assets immediately prior to the transaction exceed the adjusted bases of T Corporation's assets and X Corporation's gross receipts for the representative period are more than T Corporation's gross receipts for the period. The employment agencies are not operated as separate and distinct trades or businesses after the date of the distribution or transfer.

(ii) *Conclusion.* Because the adjusted bases of the assets and the gross receipts of X Corporation exceed the adjusted bases of the assets and the gross receipts of T Corporation, the accounting method used by X Corporation immediately prior to the date of the section 381(a) transaction is the principal method. After the section 381(a) transaction, X Corporation uses the cash receipts and disbursements method for the employment agency business operated by X Corporation prior to the section 381(a) transaction. X Corporation need not secure the Commissioner's consent to use this method. However, X Corporation must change the accounting method for the employment agency business acquired from T Corporation to the cash receipts and disbursements method and take into account the applicable section 481(a) adjustment as provided in paragraph (d)(1) of this section.

Example 2. Principal method is the acquiring corporation's carryover method—(i) *Facts.* The facts are the same as in *Example 1* except that T Corporation's gross receipts for the representative period exceed X Corporation's gross receipts.

(ii) *Conclusion.* Because the gross receipts of T Corporation exceed the gross receipts of X Corporation but the adjusted bases of the assets of T Corporation do not exceed the adjusted bases of the assets of X Corporation, the accounting method used by X Corporation immediately prior to the date of the section 381(a) transaction is the principal method. After the section 381(a) transaction, X Corporation will use the cash receipts and disbursements method for the employment agency business operated by X Corporation prior to the section 381(a) transaction. X Corporation need not secure the Commissioner's consent to use this method. However, X Corporation must change the accounting method for the employment agency business acquired from T Corporation to the cash receipts and disbursements method and take into account the applicable section 481(a) adjustment as provided in paragraph (d)(1) of this section.

Example 3. Principal method is the distributor or transferor corporation's carryover method—(i) *Facts.* The facts are the same as in *Example 1* except that the adjusted bases of T Corporation's assets immediately prior to the section 381(a) transaction exceed the adjusted bases of Corporation X's assets and T Corporation's gross receipts for the representative period are more than X Corporation's gross receipts for the period.

(ii) *Conclusion.* Because the adjusted bases of the assets and the gross receipts of T Corporation exceed the adjusted bases of the assets and the gross receipts of X Corporation, the accounting method used by T Corporation immediately prior to the date of the section 381(a) transaction is the principal method. After the section 381(a) transaction, X Corporation uses an overall accrual method for the employment agency business operated by T Corporation prior to the section 381(a) transaction. X Corporation need not secure the Commissioner's consent to use this method. However, X Corporation must change the accounting method for the employment agency business operated by X Corporation prior to the section 381(a) transaction to an overall accrual method and take into account the applicable section 481(a) adjustment as provided in paragraph (d)(1) of this section. If X Corporation chooses, it may request the Commissioner's consent to change to the cash receipts and disbursements method, if permissible, or some other permissible method as provided in paragraph (d)(2) of this section.

Example 4. Impermissible method—(i) *Facts.* The facts are the same as in *Example 1* except that X Corporation is prohibited under section 448 from using the cash receipts and disbursements method after the date of the section 381(a) transaction.

(ii) *Conclusion.* Because X Corporation is not permitted under section 448 to use the cash receipts and disbursements method, X Corporation must request permission to change to a permissible method as provided in paragraph (d)(2) of this section.

Example 5. Principal method is the acquiring corporation's carryover method with a special accounting method—(i) *Facts.* X Corporation and T Corporation publish magazines. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. Both X Corporation and T Corporation use an overall accrual method. X Corporation has elected to defer income from its subscription sales under section 455. T Corporation has not elected to defer income from its subscription sales under section 455 and instead has recognized the income from these sales in accordance with section 451. The adjusted bases of X Corporation's assets immediately prior to the section 381(a) transaction exceed the adjusted bases of T Corporation's assets and X Corporation's gross receipts for the representative period are more than T Corporation's gross receipts for the period. The publication businesses are not operated as separate and distinct trades or businesses after the date of the distribution or transfer.

(ii) *Conclusion.* Because the adjusted bases of the assets and the gross receipts of X Corporation exceed the adjusted bases of the assets and the gross receipts of T Corporation, the accounting method used by X Corporation immediately prior to the date of the section 381(a) transaction is the principal method. After the section 381(a) transaction, X Corporation will continue to use its overall accrual method and the section 455 deferral method. X Corporation need not secure the Commissioner's consent to continue to use its overall accrual method and the section 455 deferral method. However, under paragraph (d)(1) of this section X Corporation must change its accounting method for the magazine business acquired from T Corporation to the section 455 deferral method using a cut-off basis.

Example 6. Principal method is the acquiring corporation's carryover method with a special accounting method—(i) *Facts.* The facts are the same as in *Example 5* except that T Corporation's gross receipts for the representative period exceed X Corporation's gross receipts for the period.

(ii) *Conclusion.* Because the gross receipts of T Corporation exceed the gross receipts of X Corpora-

tion but the adjusted bases of the assets of T Corporation do not exceed the adjusted bases of the assets of X Corporation, the accounting method used by X Corporation immediately prior to the date of the section 381(a) transaction is the principal method. After the section 381(a) transaction, X Corporation continues to use an overall accrual method and the section 455 deferral method. X Corporation need not secure the Commissioner's consent to continue to use an overall accrual method and the section 455 deferral method. However, under paragraph (d)(1) of this section X Corporation must change its accounting method for the magazine business acquired from T Corporation to the section 455 deferral method using a cut-off basis.

(d) *Procedures for changing accounting methods*—(1) *Change made to principal method*—(i) *Section 481(a) adjustment*—(A) *In general.* The acquiring corporation does not need to secure the Commissioner's consent to use a principal method. To the extent use of a principal method constitutes a change in an accounting method, the change in accounting method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method under paragraph (c)(1) of this section, whether the change relates to the trade or business of the acquiring corporation or the trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement this accounting method change are determined under §1.446–1(e) and the applicable administrative procedures that govern voluntary changes in accounting methods under section 446(e). The appropriate section 481(a) adjustment as determined above is included in the taxable income of the acquiring corporation for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. Thus, if the administrative procedures require that an accounting method change be implemented on a cut-off basis, the acquiring corporation must implement the change, on a cut-off basis as of the date of distribution or transfer, on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the day on which the section 381(a) transaction occurs.

(B) *Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

Example. X Corporation uses the overall cash receipts and disbursements accounting method while T Corporation uses an overall accrual method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation determines that under the rules of paragraph (c)(1) of this section, X Corporation must change the accounting method for the business acquired from T Corporation to the cash receipts and disbursements method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the cash receipts and disbursements method by consolidating the adjustments (whether the amounts thereof represent increases or decreases in items of income or deductions) arising with respect to balances in the various accounts, such as accounts receivable, as of the beginning of the day that immediately follows the day on which X Corporation acquires the assets of T Corporation. This adjustment, or an appropriate part thereof, will be reflected on the federal income tax return filed by X Corporation for the taxable year that includes this section 381(a) transaction.

(ii) *Audit protection.* Notwithstanding any other provision in any other regulation or administrative procedure, no audit protection is provided for any change in accounting method under paragraph (d)(1)(i) of this section.

(iii) *Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in §1.446–1(e) and the applicable administrative procedures that govern voluntary accounting method changes under section 446(e) apply to a change in accounting method under this section. Thus, for example, if the administrative procedures that govern a particular accounting method change have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to changes made under this paragraph (d)(1). Similarly, if the administrative procedures provide as a term and condition that an identical accounting method change is barred for a period of years, this term and condition applies to changes made under this paragraph (d)(1) to bar future changes of that accounting method, if identical, for the same period, but not changes to the principal method under this section.

(2) *Change made to an accounting method other than the principal method or a carryover method.* A party to a section 381(a) transaction that desires to change to an accounting method other than the principal method as determined under paragraph (c) of this section, or a carryover method within the meaning of paragraph (a)(2)(i) of this section, must follow the provisions of §1.446–(1)(e) that govern the accounting method change, except that for an accounting method change requiring advance consent—

(i) Under the authority of §1.446–1(e)(3)(ii), the application for accounting method change (for example, Form 3115) must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in §1.446–1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(*1*) The day that is 180 days after the date of the distribution or transfer, or

(*2*) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred; and

(*ii*) An application on Form 3115 filed with the IRS should be labeled "Filed under section 381(c)(4)" at the top.

(e) *Rules and procedures*—(1) *No accounting method.* If a party to a section 381(a) transaction is not using an accounting method, does not have an accounting method for a particular item, or came into existence as a result of the transaction, the party will not be treated as having an accounting method different from that used by the other parties to the section 381(a) transaction.

(2) *Elections and adoptions allowed.* An acquiring corporation is not precluded by section 381(c)(4) or these regulations from making any election for the taxable year that includes the date of distribution or transfer that does not require the Commissioner's consent and that is otherwise permissible. Similarly, an acquiring corporation may adopt any accounting method in that year that is otherwise permissible.

(3) *Elections continue after section 381(a) transaction*—(i) *General rule.* The

acquiring corporation is not required to renew any election previously made by it or by a distributor or transferor corporation with respect to a carryover method or principal method if the acquiring corporation uses the method after a section 381(a) transaction. Furthermore, an election previously made by an acquiring corporation or by a distributor or transferor corporation with respect to a method that is in effect immediately prior to the date of distribution or transfer continues to the same extent as though the distribution or transfer had not occurred.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (e)(3):

Example 1. Election continues. The acquiring corporation, X Corporation, has previously elected to treat animals purchased for dairy purposes as property used in its trade or business subject to depreciation after maturity while otherwise using the unit-livestock-price method. X Corporation's accounting method continues after its merger with T Corporation in a transaction to which section 381(a) applies. X Corporation is not required to renew its election, and is bound by it, after the section 381(a) transaction.

Example 2. Election continues. The acquiring corporation, X Corporation, has previously elected under section 171 to amortize bond premium with respect to taxable bonds. X Corporation's method for bond premium continues after T Corporation merges with X Corporation in a transaction to which section 381(a) applies. X Corporation is not required to renew its election, and is bound by it, after the section 381(a) transaction.

(4) *Appropriate times for determining the method used and trade or business character*—(i) *Determining the accounting method.* The accounting method existing at the time of a section 381(a) transaction is the method used immediately prior to the distribution or transfer by the parties to the transaction.

(ii) *Determining whether there are separate trades or businesses after a section 381(a) transaction.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the distribution or transfer will be determined as of the time of the transaction based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year in which the section 381(a) transaction occurs.

(5) *Representative period for accumulating gross receipts.* If a party to the section 381(a) transaction was not in existence for the 12 consecutive months immediately prior to the date of distribution or transfer, then all parties to the section 381(a) transaction will compare their gross receipts for the period that the party was in existence. For example, if the acquiring corporation was formed in August and the section 381(a) transaction occurred in December of the same year, the gross receipts for those five months will be compared with the gross receipts of the other parties to the section 381(a) transaction for the same period.

(6) *Establishing an accounting method.* Notwithstanding any other provision in any other regulation or administrative procedure, an accounting method used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation in the taxable year that includes the date of distribution or transfer is an established method of accounting for purposes of section 446(e).

(7) *Other applicable provisions.* Section 381(c)(4) and these regulations do not preempt any other section of the Code or regulations that is applicable to the acquiring corporation's circumstances. For example, income, deductions, credits, allowances, and exclusions may be allocated among the parties to a section 381(a) transaction and other taxpayers under sections 269 and 482, if appropriate. Similarly, transfers of contracts accounted for using a long-term contract accounting method are governed by the rules provided in §1.460–4(k). Further, if other paragraphs of section 381(c) apply for purposes of determining accounting methods that carryover in a section 381(a) transaction, section 381(c)(4) and this §1.381(c)(4)–1 will not apply to the tax treatment of the items. For example, section 381(c)(4) and these regulations do not apply to inventories that an acquiring corporation obtains in a transaction to which section 381(a) applies. Instead, the rules of section 381(c)(5) and §1.381(c)(5)–1 govern the inventory method to be used by the acquiring corporation after the distribution or transfer. Similarly, if the acquiring corporation assumes an obligation of the distributor or transferor corporation that gives rise to a liability, within the meaning of §1.381(c)(16)–1(a)(4), the deductibility of the item is determined under section 381(c)(4) and these regulations only after the rules of section 381(c)(16) and its regulations are applied.

(8) *Character of items of income and deduction.* Items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(9) *Accounting method selected by project or job.* If other sections of the Code or regulations permit an acquiring corporation to elect an accounting method on a project-by-project, job-by-job, or other similar basis, the method elected with respect to each project or job is the established method only for that project or job. For example, the election under section 460 to classify a "hybrid contract," that is, a contract to perform both manufacturing and construction activities, as a long-term construction contract if at least 95 percent of the estimated total allocable contract costs are reasonably allocated to the construction activities is made on a contract-by-contract basis. Accordingly, the accounting method previously elected for a project or job generally continues after the section 381(a) transaction. However, if the trades or businesses of the parties to a section 381(a) transaction are not operated as separate and distinct trades or businesses after the date of distribution or transfer, and two or more of the parties to the section 381(a) transaction previously worked on the same project or job and used different accounting methods for the project or job immediately before the distribution or transfer, then the acquiring corporation must determine the method to use after the section 381(a) transaction as provided in paragraph (c) of this section.

(10) *Prohibited accounting methods.* An acquiring corporation may not use the accounting method determined under paragraph (a)(2) of this section if the method fails to reflect clearly the acquiring corporation's income within the meaning of section 446(b). Thus, section 381(c)(4) and these regulations do not limit, restrict, or otherwise prevent the Commissioner from requiring the use of another accounting method.

(f) *Effective/applicability date.* The rules of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 4. Section 1.381(c)(5)–1 is revised to read as follows:

§1.381(c)(5)–1 Inventory method.

(a) *Introduction*—(1) *Purpose.* This section provides guidance regarding the inventory accounting method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(5) apply and how to implement any associated accounting method changes. See §1.381(c)(4)–1 for guidance regarding the accounting method or combination of methods (other than inventory and depreciation accounting methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(4) apply. See §1.381(c)(6)–1 for guidance regarding the depreciation accounting methods an acquiring corporation must use following a distribution or transfer to which sections 381(a) and (c)(6) apply.

(2) *Carryover requirement*—(i) *In general.* In a transaction to which section 381(a) applies, if an acquiring corporation operates the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, then the acquiring corporation generally must use the same accounting method(s) for inventory used by the distributor or transferor corporation(s) on the date of distribution or transfer for the acquired trade or business (carryover method). If the acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, then the acquiring corporation must use a principal method as determined under paragraph (c) of this section and must take into account any section 481(a) adjustment, if applicable, as required under paragraph (d)(1) of this section. The acquiring corporation need not secure the Commissioner's consent to continue or to use a permissible carryover method or principal method.

(ii) *Carryover method or principal method not permissible.* In general, if a carryover method or principal method is an impermissible accounting method, the acquiring corporation must secure the Commissioner's consent to change to a different accounting method as provided in paragraph (d)(2) of this section. If, however, a carryover method is impermissible solely because only a single inventory method with respect to a particular type of goods may be used by the acquiring corporation after the date of the section 381(a) transaction regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation must use a principal method as determined under paragraph (c) of this section.

(iii) *Voluntary change.* All parties to a section 381(a) transaction may request permission under section 446(e) to change an inventory accounting method for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate trades or businesses after the section 381(a) transaction, an accounting method change will be granted only if the requested change is the method that the acquiring corporation must use after the date of the distribution or transfer in the taxable year that includes the section 381(a) transaction. The time and manner of obtaining the Commissioner's consent to change to a different inventory accounting method is described in paragraph (d)(2) of this section.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (a):

Example 1. Separate and distinct trades or businesses after the date of the distribution or transfer—(i) *Facts.* X Corporation manufactures radios and television sets. X Corporation uses the first-in, first-out (FIFO) inventory method to identify its inventory goods, values the goods at cost, and capitalizes costs under section 263A. T Corporation manufactures washing machines and dryers. T Corporation uses the last-in, first-out (LIFO) inventory method to identify its inventory goods, values the goods at cost, and capitalizes costs under section 263A using methods other than those used by X Corporation. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. X Corporation operates the two manufacturing operations as separate and distinct trades or businesses after the date of the section 381(a) transaction.

(ii) *Conclusion.* After the section 381(a) transaction, for the business of manufacturing radios and television sets X Corporation will use the same FIFO inventory method to identify its inventory goods, value the goods at cost, and capitalize costs under section 263A using the methods it had previously used. For the business of manufacturing washing machines and dryers X Corporation will use the same LIFO inventory method to identify its inventory goods, value the goods at cost, and capitalize costs under section 263A using the methods previously used by T Corporation. X Corporation need not secure the Commissioner's consent to continue the inventory methods.

Example 2. Impermissible method—(i) *Facts.* X Corporation manufactures food and beverages. X Corporation uses the FIFO inventory method to identify its inventory goods, values the goods at cost, and capitalizes costs under section 263A. T Corporation sells sporting equipment. T Corporation uses the FIFO inventory method to identify its inventory goods, and values the goods at cost. T Corporation did not capitalize costs under section 263A because it met the small reseller exception under section 263A. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. X Corporation operates the food and beverage business and the sporting goods business as separate trades or businesses after the date of the section 381(a) transaction. After the section 381(a) transaction, X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business.

(ii) *Conclusion.* After the section 381(a) transaction, X Corporation will continue to identify its food and beverage inventory goods by using the FIFO inventory method, value the inventory at cost, and use its previously selected cost capitalization methods under section 263A as provided in paragraph (a)(2)(i) of this section. X Corporation will continue to identify its sporting equipment inventory goods by using the FIFO inventory method and value the inventory at cost in the same manner as T Corporation did prior to the section 381(a) transaction. X Corporation need not secure the Commissioner's consent to continue these inventory methods. Because X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business, X Corporation must secure the Commissioner's consent to change to a permissible cost capitalization method under section 263A for the sporting equipment business. X Corporation must request this consent by filing a Form 3115, Application for Change in Accounting Method, using the procedures in paragraph (d)(2) of this section.

Example 3. Voluntary change—(i) *Facts.* The facts are the same as in *Example 1* except that X Corporation wants to cease valuing the radios and television sets at cost and change to the cost or market, whichever is lower, method.

(ii) *Conclusion.* X Corporation must secure the Commissioner's consent to use the cost or market, whichever is lower, method and must do so by filing a Form 3115 as described in paragraph (d)(2) of this section.

(b) *Definitions*—(1) *Inventory method* is a method used to account for merchandise on hand (including finished goods, work in process, and raw materials) at the beginning of a year for purposes of computing taxable income for that year. The term includes not only the method for iden-

tifying inventory, for example, the FIFO inventory method or the LIFO inventory method, but also all other methods necessary to account for merchandise.

(2) *Principal method* is an accounting method that is determined under paragraph (c) of this section.

(3) *Adopting an accounting method* has the same meaning as provided in §1.446–1(e)(1).

(4) *Changing an accounting method* has the same meaning as provided in §1.446–1(e)(2).

(5) *Acquiring corporation* has the same meaning as provided in §1.381(a)–1(b)(2).

(6) *Distributor corporation* means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(7) *Transferor corporation* means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (C), or (F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (G), provided the requirements of section 354(b) are met.

(8) *Parties to the section 381(a) transaction* means the acquiring corporation and the distributor or transferor corporation(s) involved in the transaction to which section 381(a) applies.

(9) *Date of distribution or transfer* has the same meaning as provided in section 381(b)(2) and §1.381(b)–1(b).

(10) *Separate and distinct trades or businesses* has the same meaning as provided in §1.446–1(d).

(11) *Audit protection* means that the IRS will not require the corporation required to change its accounting method under this section to change its method for the same item for a taxable year prior to the taxable year of the section 381(a) transaction requiring the change in accounting method.

(12) *Section 481(a) adjustment* means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of a taxpayer is computed under an accounting method different from the method used to compute taxable income for the preceding taxable year.

(13) *Cut-off basis* means an accounting method change made without a section 481(a) adjustment and under which only the goods arising on or after the date the accounting method change is made are accounted for under the new accounting method.

(14) *Adjustment period* means the number of taxable years for taking into account the section 481(a) adjustment required as a result of an accounting method change.

(c) *Principal method*—(1) *In general.* The principal method for a particular type of goods generally is the method used by the acquiring corporation for that type of goods immediately prior to the date of the section 381(a) transaction (acquiring corporation's carryover method). If, however, the acquiring corporation does not have an inventory accounting method for a particular type of goods or if the distributor or transferor corporation holds more inventory of that type of goods, the principal method for that type of goods is the method used by the distributor or transferor corporation for that type of goods immediately prior to the date of the transaction (distributor or transferor corporation's carryover method). The distributor or transferor corporation holds more inventory if, for a particular type of goods, the fair market value of the goods held by the distributor or transferor corporation exceeds the fair market value of the goods held by the acquiring corporation immediately prior to the date of distribution or transfer. Alternatively, as a simplifying convention, the acquiring corporation may elect to apply the preceding sentence to the value of the entire inventories of the distributor or transferor corporation and the acquiring corporation rather than to each particular type of goods.

(2) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. Principal method is the acquiring corporation's carryover method—(i) *Facts.* X Corporation and T Corporation are manufacturers of tennis equipment. Both X Corporation and T Corporation value their inventories at cost but use different methods to capitalize costs under section 263A. X Corporation uses the simplified production method without the historic absorption ratio election provided in §1.263A–2(b)(3). T Corporation uses the simplified production method with the historic absorption ratio election provided in §1.263A–2(b)(4). Furthermore, X Corporation identifies its inventory using the FIFO inventory method, while T Corporation identifies its inventory using the LIFO inventory method.

X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. The manufacturing businesses are not operated as separate and distinct trades or businesses after the date of the distribution or transfer. Immediately prior to the acquisition, the fair market value of each particular type of goods in X Corporation's inventory exceeds the fair market value of each particular type of goods in T Corporation's inventory.

(ii) *Conclusion.* After the section 381(a) transaction, X Corporation will continue to identify its inventory using the FIFO inventory method, value its inventory at cost, and use the simplified production method without the historic absorption ratio election because the FIFO inventory method is the principal method for identifying inventory, cost is the principal method for valuing inventories, and the simplified production method without the historic absorption ratio election is the principal method for allocating costs to ending inventory under section 263A. X Corporation need not secure the Commissioner's consent to use these methods. However, with respect to the inventory acquired from T Corporation, X Corporation will change the method of identifying inventory to the FIFO inventory method, use the simplified production method without the historic absorption ratio election, and take into account the applicable section 481(a) adjustment as provided in paragraph (d)(1) of this section. If X Corporation chooses, it may request the Commissioner's consent to change to another permissible method as provided in paragraph (d)(2) of this section.

Example 2. Principal method is the distributor or transferor corporation's carryover method—(i) *Facts.* The facts are the same as in *Example 1* except that the fair market value of each particular type of goods in T Corporation's inventory is in excess of the fair market value of each particular type of goods in X Corporation's inventory.

(ii) *Conclusion.* After the section 381(a) transaction, X Corporation will identify its inventory using the LIFO inventory method used by T Corporation, value its inventories at cost, and use the simplified production method with the historic absorption ratio election, because the LIFO inventory method used by T Corporation is the principal method for identifying inventory, cost is the principal method for valuing inventories, and the simplified production method with the historic absorption ratio election is the principal method for allocating costs to ending inventory under section 263A. X Corporation need not secure the consent of the Commissioner to use these methods. However, with respect to the inventory manufactured by X Corporation prior to the section 381(a) transaction, X Corporation will change its methods as needed by using the procedures of paragraph (d)(1) of this section. Specifically, X Corporation will change its method of identifying inventory to the LIFO inventory method using a cut-off basis and change its cost capitalization method to the simplified production method with the historic absorption ratio election by taking into account the applicable section 481(a) adjustment. If X Corporation chooses, it may request the Commissioner's consent to change to another permissible method as provided in paragraph (d)(2) of this section.

Example 3. Principal method is the acquiring corporation's carryover method—(i) *Facts.* The facts are the same as in *Example 1* except that the fair market values of the inventories of X Corporation and T Corporation are identical.

(ii) *Conclusion.* After the section 381(a) transaction, X Corporation will continue to identify its inventory using the FIFO inventory method, value its inventory at cost, and use the simplified production method without the historic absorption ratio election because the FIFO inventory method is the principal method for identifying inventory, cost is the principal method for valuing inventories, and the simplified production method without the historic absorption ratio election is the principal method for allocating costs to ending inventory under section 263A. X Corporation need not secure the Commissioner's consent to use these methods. However, with respect to the inventory acquired from T Corporation, X Corporation will change the method of identifying inventory to the FIFO inventory method, use the simplified production method without the historic absorption ratio election, and take into account the applicable section 481(a) adjustment as provided in paragraph (d)(1) of this section. If X Corporation chooses, it may request the Commissioner's consent to change to another permissible method as provided in paragraph (d)(2) of this section.

Example 4. Inventory convention elected—(i) *Facts.* X Corporation manufactures planes and T Corporation manufactures planes and pool tables. X Corporation identifies its inventory using the FIFO inventory method and values it at cost or market, whichever is lower, while T Corporation identifies its inventory using the LIFO inventory method and values it at cost. Both X Corporation and T Corporation use the same method to capitalize costs under section 263A.

X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. The manufacturing businesses are not operated as separate and distinct trades or businesses after the date of the distribution or transfer. In lieu of determining the fair market value of each particular type of goods held on the date of distribution or transfer, X Corporation elects to value the entire inventories held by itself and T Corporation. Immediately prior to the acquisition, the fair market value of T Corporation's inventory exceeds the fair market value of X Corporation's inventory.

(ii) *Conclusion.* After the section 381(a) transaction, X Corporation will identify its inventory using the LIFO inventory method used by T Corporation and value this inventory at cost because the LIFO inventory method used by T Corporation is the principal method for identifying inventory and cost is the principal method for valuing inventories. X Corporation need not secure the consent of the Commissioner to use these methods. However, with respect to the inventory manufactured by X Corporation prior to the section 381(a) transaction, X Corporation will change the method of identifying inventory to the LIFO inventory method on a cut-off basis and will take into account the change in the inventory amount resulting from the valuing of the inventory at cost as required under section 472(d) as provided in paragraph (d)(1) of this section. The method used prior to the section 381(a) transaction to capitalize costs under section 263A continues after the transaction. If X Corporation chooses, it may request the Commissioner's consent to change to another permissible method as provided in paragraph (d)(2) of this section.

(d) *Procedures for changing accounting methods*—(1) *Change made to principal method*—(i) *Section 481(a) adjustment*—(A) *In general.* The acquiring corporation does not need to secure the Commissioner's consent to use a principal method. To the extent use of a principal method constitutes a change in an accounting method, the change in accounting method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method under paragraph (c) of this section, whether the change relates to the trade or business of the acquiring corporation or the trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement this accounting method change are determined under §1.446–1(e) and the applicable administrative procedures that govern voluntary changes in accounting methods under section 446(e). The appropriate section 481(a) adjustment as determined above is included in the taxable income of the acquiring corporation for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. Thus, if the administrative procedures require that an accounting method change be implemented on a cut-off basis, the acquiring corporation must implement the change, on a cut-off basis as of the date of distribution or transfer, on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the section 381(a) transaction and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the day on which the section 381(a) transaction occurs.

(B) *Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

Example. X Corporation uses the FIFO inventory method while T Corporation uses the LIFO inventory method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies on July 15th. X Corporation determines that under the rules of paragraph (c)(1) of this section, X Corporation must change the inventory method for the business acquired from T Corporation to the FIFO inventory method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the FIFO inventory method (whether the amounts thereof represent increases or decreases in income) as of the beginning of July 16th. This adjustment, or an appropriate part thereof, will be included in X Corporation's federal income tax return for the taxable year that includes July 15th.

(ii) *Audit protection.* Notwithstanding any other provision in any other regulation or administrative procedure, no audit protection is provided for any change in accounting method under paragraph (d)(1)(i) of this section.

(iii) *Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in §1.446–1(e) and the applicable administrative procedures that govern voluntary changes in accounting methods under section 446(e) apply to a change in accounting method under this section. Thus, for example, if the administrative procedures that govern a particular accounting method change have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to changes made under this paragraph (d)(1). Similarly, if the administrative procedures provide as a term and condition that an identical accounting method change is barred for a period of years, this term and condition applies to changes made under this paragraph (d)(1) to bar future changes of that accounting method, if identical, for the same period, but not changes to the principal method under this section.

(2) *Change made to an accounting method other than the principal method or a carryover method.* A party to a section 381(a) transaction that desires to change to an accounting method other than the principal method as determined under paragraph (c) of this section, or a carryover method within the meaning of paragraph (a)(2)(i) of this section, must follow the provisions of §1.446–(1)(e) that govern the accounting method change, ex-

cept that for an accounting method change requiring advance consent—

(i) Under the authority of §1.446–1(e)(3)(ii), the application for accounting method change (for example, Form 3115) must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in §1.446–1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(*1*) The day that is 180 days after the date of the distribution or transfer, or

(*2*) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred; and

(ii) An application on Form 3115 filed with the IRS should be labeled "Filed under section 381(c)(5)" at the top.

(e) *Rules and procedures*—(1) *Inventory method selected for a particular type of goods*. If other sections of the Code or Income Tax Regulations allow a taxpayer to elect an inventory method for a particular type of goods, the method elected with respect to those goods is the established inventory method only for those goods. For example, an election to use the LIFO inventory method to identify specified goods in inventory, such as certain products in finished goods, is the inventory method only for those products.

(2) *No accounting method*. If a party to a section 381(a) transaction is not using an inventory method, does not have a particular type of goods immediately prior to the date of distribution or transfer, or came into existence as a result of the transaction, the party will not be treated as having an inventory accounting method different from that used by the other parties to the section 381(a) transaction.

(3) *Elections and adoptions allowed*. An acquiring corporation is not precluded by section 381(c)(5) or these regulations from making any election for the taxable year that includes the date of distribution or transfer that does not require the Commissioner's consent and that is otherwise permissible. Similarly, an acquiring corporation may adopt any accounting method in that year that is otherwise permissible. For example, an acquiring corporation may elect to identify its inventory using the LIFO inventory method in the year of the distribution or transfer.

(4) *Elections continue after section 381(a) transaction*. The acquiring corporation is not required to renew any election previously made by it or by a distributor or transferor corporation with respect to a carryover method or principal method if the acquiring corporation uses the method after a section 381(a) transaction. Furthermore, an election previously made by an acquiring corporation or by a distributor or transferor corporation with respect to a method that is in effect immediately prior to the date of distribution or transfer continues to the same extent as though the distribution or transfer had not occurred. For example, when the acquiring corporation has elected to use the LIFO inventory method under section 472 prior to the date of the section 381(a) transaction and the method continues after the transaction, the acquiring corporation need not renew this inventory election and is bound by it after the date of the transaction.

(5) *Adopting the LIFO inventory method*. A party to a section 381(a) transaction will be deemed to be using the LIFO inventory method with respect to a particular type of goods on the date of distribution or transfer if such party elects under section 472 to adopt that inventory method with respect to those goods for its taxable year within which the date of distribution or transfer occurs. See section 472 for the requirements to adopt the LIFO inventory method.

(6) *Inventory layers treatment*—(i) *Adjustments required after a section 381(a) transaction*. An acquiring corporation that determines the principal method of taking an inventory after a section 381(a) transaction under paragraph (c) of this section may need to integrate inventories and make appropriate adjustments as provided in paragraphs (e)(6)(ii) and (iii) of this section.

(ii) *LIFO inventory method used after the section 381(a) transaction*—(A) *LIFO inventory method used by the distributor or transferor corporation*—(*1*) *Dollar-value method*. If an acquiring corporation is required to use the LIFO dollar-value method of pricing inventories (dollar-value method) for a particular type of goods for its taxable year that includes the date of the section 381(a) transaction, and immediately prior to the distribution or transfer the distributor or transferor corporation used the specific goods method of pricing inventories for that particular type of goods, the inventory of the distributor or transferor corporation shall be placed on the dollar-value method as provided in §1.472–8(f), and then the inventory shall be integrated with the inventory of the acquiring corporation. If pools of each corporation are required to be combined, the pools shall be combined as provided in §1.472–8(g)(2). For purposes of combining pools, all base-year inventories or layers of increment that occur in taxable years including the same December 31 shall be combined. A base-year inventory or layer of increment occurring in any short taxable year not including a December 31, or in the final taxable year of a distributor or transferor corporation, shall be merged with and considered a layer of increment of its immediately preceding taxable year.

(*2*) *Specific goods method*. If an acquiring corporation is required to use the specific goods method of pricing inventories for a particular type of goods for its taxable year that includes the date of the section 381(a) transaction, and immediately prior to the distribution or transfer the distributor or transferor corporation used the LIFO inventory method for that particular type of goods, the inventory shall be treated by the acquiring corporation as having the acquisition dates and costs of the distributor or transferor corporation.

(B) *LIFO inventory method not used by the distributor or transferor corporation*. If an acquiring corporation is required to use the LIFO inventory method for a particular type of goods for its taxable year that includes the date of the section 381(a) transaction, and immediately prior to the distribution or transfer the distributor or transferor corporation did not use the LIFO inventory method for that particular type of goods, the inventory shall be treated by the acquiring corporation as having been acquired at their average unit cost in a single transaction on the date of the distribution or transfer. Thus, if an inventory of a particular type of goods is combined in an existing dollar-value pool, the goods shall be treated as if they were purchased by the acquiring corporation at the average unit cost on the date of the distribution or transfer with respect to such pool. Alternatively, if the goods are not combined in an existing pool, the goods will be treated as if they were purchased by the acquiring

corporation at the average unit cost on the date of the distribution or transfer with respect to a new pool, with the base-year being the year of the section 381(a) transaction. Adjustments resulting from a restoration to cost of any write-down to market value of the inventories of a distributor or transferor corporation shall be taken into account by the distributor or transferor corporation in its final taxable year ending on the date of the distribution or transfer. See section 472(d).

(iii) *FIFO inventory method used after the section 381(a) transaction*—(A) *FIFO inventory method used by the distributor or transferor corporation.* If an acquiring corporation is required to use the FIFO inventory method for a particular type of goods for its taxable year that includes the date of the section 381(a) transaction, and immediately prior to the distribution or transfer the distributor or transferor corporation used the FIFO inventory method for that particular type of goods, the inventory of that type of goods shall be treated by the acquiring corporation as having the same acquisition dates and costs as the distributor or transferor corporation. However, if the acquiring corporation values its inventories at cost or market, whichever is lower, the acquiring corporation shall treat the inventories of the distributor or transferor corporation as having been acquired at cost or market, whichever is lower.

(B) *FIFO inventory method not used by the distributor or transferor corporation.* If an acquiring corporation is required to use the FIFO inventory method for a particular type of goods for its taxable year that includes the date of the section 381(a) transaction, and immediately prior to the distribution or transfer the distributor or transferor corporation did not use the FIFO inventory method for that particular type of goods, the inventory of the distributor or transferor corporation shall be treated by the acquiring corporation as having the same acquisition dates and costs that the inventory would have had if the distributor or transferor corporation had been using the FIFO inventory method for its taxable year ending on the date of distribution or transfer. However, if the acquiring corporation values its inventories at cost or market, whichever is lower, the acquiring corporation shall treat the acquired inventories as having been acquired at cost or market, whichever is lower.

(7) *Appropriate times for determining the method used and trade or business character*—(i) *Determining the accounting method.* The accounting method existing at the time of a section 381(a) transaction is the method used immediately prior to the date of distribution or transfer by the parties to the transaction.

(ii) *Determining whether there are separate trades or businesses after a section 381(a) transaction.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the distribution or transfer will be determined at the time of the transaction based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year in which the section 381(a) transaction occurs.

(8) *Establishing an accounting method for taking an inventory.* Notwithstanding any other provision in any other regulation or administrative procedure, an accounting method used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation in the taxable year that includes the date of distribution or transfer is an established method of accounting for purposes of section 446(e).

(9) *Other applicable provisions.* Section 381(c)(5) and these regulations do not preempt any other section of the Code or regulations that is applicable to the acquiring corporation's circumstances. Section 381(c)(5) and this §1.381(c)(5)–1 determine only the inventory method to be used after a section 381(a) transaction. Specifically, section 381(c)(5) and this §1.381(c)(5)–1 do not apply to assets other than inventory that an acquiring corporation obtains in a transaction to which section 381(a) applies.

(10) *Use of the cash receipts and disbursements method.* If a party to a section 381(a) transaction uses the cash receipts and disbursements method within the meaning of section 446(c)(1) and §1.446–1(c)(1)(i), or is not required to use inventory accounting methods for its goods, immediately prior to the date of distribution or transfer, section 381(c)(5) and §1.381(c)(5)–1 do not apply. Section 381(c)(4) and §1.381(c)(4)–1 must be applied to determine the accounting methods that continue after the transaction.

(11) *Character of items of income and deduction.* Items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(12) *Prohibited methods.* An acquiring corporation may not use the accounting method determined under paragraph (a)(2) of this section if the method fails to reflect clearly the acquiring corporation's income within the meaning of section 446(b). Thus, section 381(c)(5) and these regulations do not limit, restrict, or otherwise prevent the Commissioner from requiring the use of another accounting method.

(f) *Effective/applicability date.* The rules of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 5. Section 1.446–1 is amended by:

1. Revising the first sentence in paragraph (e)(3)(i) and adding a second new sentence.

2. Revising the first sentence in paragraph (e)(4)(i).

3. Adding paragraph (e)(4)(iii).

The revisions and addition read as follows:

§1.446–1 General rule for methods of accounting.

* * * * *

(e) * * *

(3) * * *(i) Except as otherwise provided under the authority of paragraph (e)(3)(ii) of this section, to secure the Commissioner's consent to a taxpayer's change in method of accounting, the taxpayer generally must file an application on Form 3115 with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. See §§1.381(c)(4)–1(d)(2) and 1.381(c)(5)–1(d)(2) for rules allowing

additional time, in some circumstances, for the filing of an application on Form 3115 with respect to a transaction to which section 381(a) applies.

* * * * *

(4) * * *(i) *In general.* Except as provided in paragraphs (e)(3)(iii), (e)(4)(ii) and (e)(4)(iii) of this section, paragraph (e) of this section applies on or after December 30, 2003.

* * * * *

(iii) *Effective/applicability date for paragraph (e)(3)(i).* The rules of paragraph (e)(3)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 15, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 16, 2007, 72 F.R. 64545)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Information Reporting on Employer-Owned Life Insurance Contracts

REG–115910–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: Elsewhere in this issue of the Bulletin, the IRS is issuing temporary regulations concerning information reporting on employer-owned life insurance contracts under section 6039I of the Internal Revenue Code (Code). The temporary regulations generally apply to taxpayers that are engaged in a trade or business and that are directly or indirectly a beneficiary of a life insurance contract covering the life of an insured who is an employee of the trade or business on the date the contract is issued. The text of those temporary regulations (T.D. 9364) also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by January 14, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–115910–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–115910–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC, or sent the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–115910–07).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Linda K. Boyd, 202–622–3970; concerning submissions and requests for a public hearing, contact Kelly Banks, 202–622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

The Pension Protection Act of 2006, Public Law No. 109–280, 120 Stat. 780 (2006), added sections 101(j) and 6039I to the Internal Revenue Code concerning employer-owned life insurance contracts.

Section 101(j)(1) provides that in the case of an employer-owned life insurance contract, the amount of death benefits excluded from gross income under section 101(a) shall not exceed an amount equal to the sum of the premiums and other amounts paid by the policyholder for the contract. Section 101(j)(2), however, sets forth exceptions to this rule for certain contracts for which notice and consent and other requirements are met. Section 6039I requires information reporting with respect to certain employer-owned life insurance contracts at such time and in such manner as the Secretary shall by regulations prescribe.

Temporary regulations in this issue of the Bulletin provide that the Commissioner may prescribe the form and manner of satisfying the reporting requirements imposed by section 6039I. The preamble to the temporary regulations explains the temporary regulations.

Special Analyses

It has been determined that this proposed regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation.

The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to this proposed regulation because the regulation does not impose a collection of information on small entities. Even though a substantial number of small businesses may be subject to the requirements of section 6039I, it is anticipated that whatever requirements the Commissioner may prescribe pursuant to this regulation will not impose a "significant economic impact" because the information requested will already be available to taxpayers and the burden of compliance will be minimal.

Pursuant to section 7805(f) of the Internal Revenue Code, this Regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

The IRS and Treasury Department are aware that guidance may be needed under section 101(j) and request comments on that provision as well. In particular, comments are requested on the need for guidance concerning (1) determination of the status of insured individuals as "highly compensated employees" or "highly compensated individuals;" (2) requirements a taxpayer must meet to satisfy the notice and consent requirements of section 101(j)(4); and (3) the consequences of a section 1035 exchange of an employer-owned life insurance contract. The IRS and Treasury Department anticipate that future guidance, if any, under section 101(j) will not be applied retroactively to the detriment of taxpayers who make a good faith effort to comply with section 101(j) based on a reasonable interpretation of that provision.

Drafting Information

The principal author of these regulations is Linda K. Boyd, Office of Associate Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6039I–1 also issued under 26 U.S.C. 6039I. * * *

Par. 2. Section 1.6039I–1 is added to read as follows:

§1.6039I–1 Reporting of certain employer-owned life insurance contracts.

[The text of this proposed section is the same as the text of §1.6039I–1T published elsewhere in this issue of the bulletin].

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 13, 2007, 72 F.R. 63838)

Suspension of Tax-Exempt Status of an Organization Identified With Terrorism

Announcement 2007–113

I. Purpose

This announcement is a public notice of the suspension under section 501(p) of the Internal Revenue Code of the federal tax exemption of a certain organization that has been designated as supporting or engaging in terrorist activity or supporting terrorism. Contributions made to an organization during the period that the organization's tax-exempt status is suspended are not deductible for federal tax purposes.

II. Background

The federal government has designated a number of organizations as supporting or engaging in terrorist activity or supporting terrorism under the Immigration and Nationality Act, the International Emergency Economic Powers Act, and the United Nations Participation Act of 1945. Federal law prohibits most contributions to organizations that have been so designated.

Section 501(p) of the Code was enacted as part of the Military Family Tax Relief Act of 2003 (P. L. 108–121), effective November 11, 2003. Section 501(p)(1) suspends the exemption from tax under section 501(a) of any organization described in section 501(p)(2). An organization is described in section 501(p)(2) if the organization is designated or otherwise individually identified (1) under certain provisions of the Immigration and Nationality Act as a terrorist organization or foreign terrorist organization; (2) in or pursuant to an Executive Order which is related to terrorism and issued under the authority of the International Emergency Economic Powers Act or section 5 of the United Nations Participation Act of 1945 for the purpose of imposing on such organization an economic or other sanction; or (3) in or pursuant to an Executive Order issued under the authority of any federal law, if the organization is designated or otherwise individually identified in or pursuant to the Executive Order as supporting or engaging in terrorist activity (as defined in the Immigration and Nationality Act) or supporting terrorism (as defined in the Foreign Relations Authorization Act) and the Executive Order refers to section 501(p)(2).

Under section 501(p)(3) of the Code, suspension of an organization's tax exemption begins on the date of the first publication of a designation or identification with respect to the organization, as described above, or the date on which section 501(p) was enacted, whichever is later. This suspension continues until all designations and identifications of the organization are rescinded under the law or Executive Order under which such designation or identification was made.

Under section 501(p)(4) of the Code, no deduction is allowed under any provision of the Internal Revenue Code for any contribution to an organization during any period in which the organization's tax exemption is suspended under section 501(p). Thus, for example, no charitable contribution deduction is allowed under section 170 (relating to the income tax), section 545(b)(2) (relating to undistributed personal holding company income), section 556(b)(2) (relating to undistributed foreign personal holding company income), section 642(c) (relating to charitable set asides), section 2055 (relating to the estate tax), section 2106(a)(2) (relating to the estate tax for nonresident aliens) and section 2522 (relating to the gift tax) for contributions made to the organization during the suspension period.

On November 15, 2007, the organization listed below was designated under Executive Order 13224, entitled "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten To Commit, or Support Terrorism."

III. Notice of Suspension and Non-deductibility of Contributions

The organization whose tax exemption has been suspended under section 501(p) and the effective date of such suspension are listed below. Contributions made to this organization during the period of suspension are not deductible for federal tax purposes.

Tamils Rehabilitation Organization Inc.
Cumberland, MD
Effective date: 11–15–07

IV. Federal Tax Filings

An organization whose exempt status has been suspended under section 501(p) does not file Form 990 and is required to file the appropriate Federal income tax returns for the taxable periods beginning on the date of the suspension. The organization must continue to file all other appropriate federal tax returns, including employment tax returns, and may also have to file federal unemployment tax returns.

V. Contact Information

For additional information regarding the designation or identification of an organization described in section 501(p)(2), contact the Compliance Division at the Office of Foreign Assets Control of the U.S. Treasury Department at 202–622–2490. Additional information is also available for download from the Office's Internet Home Page at *www.treas.gov/offices/eotffc/ofac/index.html*

For additional information regarding the suspension of the federal tax exemption of an organization under section 501(p), contact Ward L. Thomas at (202) 283–8913 at the Internal Revenue Service.

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2007–115

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on December 17, 2007, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Somolian Women's Association
Hopkins, MN
The Charitable ASP Family Foundation
Sun City, AZ
Prisma Zona Explorotia De Puerto Rico
San Juan, PR
Design Coalition, Inc.
Madison, WI
RVing Women
Apache Junction, AZ
Black Heritage Society, Inc.
Houston, TX
Affordable Housing USA, Inc.
Camarillo, CA
Consumer Credit Education and Counseling, Inc.
Huntsville, AL
United Debt Counseling, Inc.
Fort Lauderdale, FL
Chicago Principals and Administrators
Chicago, IL

Withholding Procedure Under Section 1441 for Certain Distributions to Which Section 302 Applies; Correction

Announcement 2007–116

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to proposed regulations (REG–140206–06, 2007–46 I.R.B. 1006) that were published in the **Federal Register** on Wednesday, October 17, 2007 (72 FR 58781) regarding a withholding agent's obligation to withhold and report tax under Chapter 3 of the Internal Revenue Code when there is a distribution in redemption of stock of a corporation that is actively traded on an established financial market.

FOR FURTHER INFORMATION CONTACT: Kathryn Holman at (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking (REG–140206–06) that is the subject of this correction is under section 1441 of the Internal Revenue Code.

Need for Correction

As published, this notice of proposed rulemaking (REG–140206–06) contains an error that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the notice of proposed rulemaking (REG–140206–06) that was the subject of FR. Doc. E7–20504 is corrected as follows:

On page 58781, column 3, in the preamble, under the caption "FOR FURTHER INFORMATION CONTACT:", line 2, the language "Kathryn Holman, (202) 622–3440 (not a" is corrected to read "Kathryn Holman, (202) 622–3840 (not a".

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on November 7, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 8, 2007, 72 F.R. 63143)

Foundations Status of Certain Organizations

Announcement 2007–117

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

African Alliance of Aid for Development, Oak Park, MI
Arch Way Housing Program, Inc., Kennesaw, GA
Arkansas Hope Incorporation, Little Rock, AR
Bereavement Care Foundation, Orange, NJ
B L House of Rufuge Outreach, Inc., Selma, AL
Bless the Beasts and the Children Foundation, Henderson, NV
Blessed & Highly Favoured Corporation, Cincinnati, OH
Blue Solutions, Austin, TX
By My Side Ltd., Philadelphia, PA
Chester Youth Development Foundation, Columbia, SC
Cindy M. Beaudoin Scholarship Fund, Plainfield, CT
Community Transportation Service, Inc., Idaho Falls, ID
Computer Knowledge 4 Kids, Arlington, TX
Cornerstone Ministries, Inc., McKinney, TX
Deliverance House, Inc., Atlanta, GA
Fordney Foundation, Anaheim, CA
Friends for Life Corporation, Moreno Valley, CA
Friends of the Fairview Bridge, Fairview, MT
Gethsemane Betterment Foundation, Vallejo, CA
Hair for Humanity, Los Angeles, CA
Heavenly Good Catering Community Development Corporation, Chesapeake, VA
H E R S Alliance and Resource Center, Inc., Coconut Creek, FL
J Maxwell & Associates, Inc., Londonderry, NH
Joshua Generation Child & Family Development Corporation, Durham, NC
Kiobvi Soul Society, Inc., Springfield Gardens, NY
Loja Health Specialist, Inc., Sykesville, MD
Lower Little River Watershed Coalition, Ashdown, AR
Mater Tech Workforce Development Center, Milwaukee, WI
New York Institute for Cognitive and Behavioral Therapies, Brooklyn, NY
Non Profit Assistance, Inc., Burnsville, MN
Our Forgotten Heritage, Inc., Bremen, OH
Peachcrest, Inc., Atlanta, GA
Project New Ground, Inc., Brooklyn, NY
Self Motivated Individuals, Philadelphia, PA
Shinyanga Health Aide and Medical Assistance, Inc., Houston, TX
Skin Cancer Awareness Foundation, Minden, NV
Unity Hope Centers, Inc., Detroit, MI
Wisconsin Education for Children and Adults Food Programs, Inc., Madison, WI
Workplace Education Institute, Inc., North Canton, OH
Yanks Air Museum Foundation, Baldwin Park, CA
Youths Working for Change, Long Beach, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.45G–1: Railroad track maintenance credit.

T.D. 9365

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Railroad Track Maintenance Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations that provide rules for claiming the railroad track maintenance credit under section 45G of the Internal Revenue Code for qualified railroad track maintenance expenditures paid or incurred by a Class II railroad or Class III railroad and other eligible taxpayers during the taxable year. These final regulations reflect changes to the law made by the American Jobs Creation Act of 2004, the Gulf Opportunity Zone Act of 2005, and the Tax Relief and Health Care Act of 2006.

DATES: *Effective Date:* These regulations are effective on November 13, 2007.

Applicability Date: For dates of applicability, see §1.45G–1(g).

FOR FURTHER INFORMATION CONTACT: David Selig, (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(d)) under control number 1545–2031.

The collection of information in these final regulations is in §1.45G–1(d). This information is required to enable the IRS to verify the assignments of railroad track miles made under section 45G(b).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to this collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 to provide regulations under section 45G of the Internal Revenue Code (Code). Section 45G was added to the Code by section 245(a) of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418) (AJCA), and was modified by section 403(f) of the Gulf Opportunity Zone Act of 2005, Public Law 109–135 (119 Stat. 2577), and section 423(a) of the Tax Relief and Health Care Act of 2006, Public Law 109–432 (120 Stat. 2922) (TRHCA). On September 8, 2006, the IRS and Treasury Department published in the **Federal Register** temporary and proposed regulations (REG–142270–05, 2006–43 I.R.B. 791) under section 45G (71 FR 53009, 71 FR 53053). The IRS and Treasury Department issued a correction notice for the temporary regulations in T.D. 9286, 2006–43 I.R.B. 750, on December 8, 2006 (71 FR 71039). No requests were received to testify on the proposed regulations and, accordingly, no public hearing was held. Written and electronic comments responding to the proposed regulations were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision and the corresponding temporary regulations are removed.

General Overview

Section 38 allows a credit for the taxable year for, among other things, the current year business credit. The current year business credit is the sum of the credits listed in section 38(b). Section 245(c)(1) of the AJCA amended section 38(b) to add to the list of credits the railroad track maintenance credit (RTMC) determined under section 45G(a).

Section 45G(a) provides that, for purposes of section 38, the RTMC for the taxable year is an amount equal to 50 percent of the qualified railroad track maintenance expenditures (QRTME) paid or incurred by an eligible taxpayer during the taxable year.

Section 45G(b) imposes limitations on the amount of the RTMC for any taxable year. The credit allowed under section 45G(a) may not exceed $3,500 multiplied by the sum of (1) the number of miles of railroad track owned by, or leased to, the eligible taxpayer as of the close of the taxable year, and (2) the number of miles of railroad track assigned to the eligible taxpayer by a Class II railroad or Class III railroad that owns or leases the track as of the close of the taxable year.

Section 45G(c) defines an eligible taxpayer to mean any Class II railroad or Class III railroad, and any person who transports property using the rail facilities of such a railroad, or who furnishes railroad-related property or services to such a railroad, but only with respect to miles of railroad track assigned to such person by a Class II railroad or Class III railroad.

Section 45G(d), as amended by section 423(a) of the TRHCA, defines the term QRTME to mean gross expenditures (whether or not chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditures given by the

Class II or Class III railroad which made the assignment of such track).

Section 45G(e) defines the terms Class II railroad and Class III railroad to have the respective meanings given those terms by the Surface Transportation Board (STB).

Under section 45G(f), section 45G applies to QRTME paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008. The amendments to section 45G(d) made by section 423(a) of the TRHCA apply retroactively to taxable years beginning after December 31, 2004.

Summary of Comments

Eligible Taxpayers

A commentator suggested that the final regulations clarify that a Class II or Class III railroad may not be recharacterized as an ineligible taxpayer because the railroad is a member of a controlled group of corporations under section 45G(e)(2) that includes a Class I railroad. Section 45G(c)(1) defines the term eligible taxpayer to include any Class II or Class III railroad. Section 45G(e)(1) provides that the terms Class II railroad and Class III railroad have the respective meanings given such terms by the STB. The controlled group rules do not affect the class designations made by the STB. The temporary regulations did not prescribe that the class designations made by the STB be superseded by the controlled group rules. Nevertheless, in response to the comment, the final regulations in §1.45G–1(b)(1) state explicitly that the definitions of Class II and Class III railroads are determined without regard to the controlled group rules under section 45G(e)(2).

Effect on Reimbursements

Commentators stated that the reimbursement rule in §1.45G–1T(c)(3)(ii) of the temporary regulations prevents eligible taxpayers from being made whole for their expenditures on railroad track infrastructure, because the credit is only for 50 percent of eligible expenditures. Under §1.45G–1T(c)(3)(ii), QRTME is treated as not paid or incurred during the taxable year to the extent that a taxpayer is entitled to reimbursement of any expenditures that would otherwise qualify as QRTME. Section 1.45G–1T(c)(3)(ii) further provides that reimbursements may consist of amounts paid either directly or indirectly to the taxpayer. Examples of indirect reimbursements in the temporary regulations include discounted freight shipping rates, price markups of railroad-related property, debt forgiveness, and similar arrangements. Thus, §1.45G–1T(c)(3)(ii) limits the QRTME paid or incurred to the actual out-of-pocket expenditures paid or incurred by an eligible taxpayer.

On December 20, 2006, Congress enacted the TRHCA, which changed the definition of QRTME. Although statutory changes other than technical corrections are usually made prospectively, this change to the statute was made retroactive to the original date of enactment of section 45G. The new definition provides that QRTME is not reduced by the discount amount in the case of discounted freight shipping rates, the increment in a markup of the price for track materials, or by debt forgiveness or cash payments made by the Class II or Class III railroad to the assignee as consideration for railroad track maintenance expenditures. Consideration received directly or indirectly from persons other than the Class II or Class III railroad, however, does reduce the amount of QRTME. See Joint Committee on Taxation Staff, *General Explanation of Tax Legislation Enacted in the 109th Congress*, 109th Cong., 2d Sess. 769 (January 17, 2007).

Consistent with the change to the statute, the final regulations retroactively limit the application of the reimbursement rule in §1.45G–1(c)(3)(ii) to consideration received directly or indirectly from persons other than the Class II or Class III railroad. A taxpayer that relied on the reimbursement rule in §1.45G–1T(c)(3)(ii) and reduced its QRTME reported on Form 8900, "*Qualified Railroad Track Maintenance Credit*," that was filed with the taxpayer's Federal income tax return, may amend its return to apply §1.45G–1(c)(3)(ii) to the taxable year provided the taxpayer applies all of §1.45G–1 to the taxable year.

Basis Adjustment

Commentators suggested that the basis reduction required by section 45G(e)(3) should only be taken by the Class II or Class III railroad owning the railroad track even if an assignee claims the RTMC. Section 45G(e)(3) requires that if a credit is allowed with respect to any railroad track, the basis of such track shall be reduced by the amount of the credit so allowed. Section 1.45G–1T(e) of the temporary regulations provides rules for adjusting basis for the amount of the RTMC claimed by an eligible taxpayer. The temporary regulations provide that for purposes of the basis adjustment under section 45G(e)(3), railroad track is the asset, if any, to which the QRTME must be capitalized, whether the asset is tangible or intangible. Therefore, the only basis that is reduced under section 45G(e)(3) is basis created by capitalizing the QRTME.

Congress commonly includes a basis adjustment rule when it enacts business tax credits as an investment incentive. See, for example, sections 43(d), 44(e), 45D(h), 45F(f), 45H(d), 45L(e), and 280C. The purpose of a basis adjustment is to prevent the taxpayer who claims the credit from obtaining a double tax benefit by also including the expenditures on which the credit was claimed in the basis of the asset created by the expenditures. Section 45G(e)(3) is clear and requires that the basis be reduced on the track with respect to which the credit is allowed. Therefore, to further the intent of Congress by preventing the double tax benefit, the basis adjustment rule must require that the increase in basis of property that results from the QRTME (without regard to the basis adjustment rule) be reduced by the amount of the credit allowed with respect to such QRTME. Allowing the reduction in basis by a taxpayer other than the taxpayer claiming the credit on property other than the property whose basis is increased by the QRTME (without regard to the basis adjustment rule) is contrary to the statute. Therefore, the final regulations do not adopt the commentators' suggestion.

Commentators also suggested that the definition of railroad track under section 45G(e)(3) should be limited to rails, ties, ballast, and other track materials. As stated previously, section 45G(e)(3) requires that basis be reduced on the track with respect to which the credit is allowed. The credit is allowed with respect to QRTME expended on railroad track. The definition of railroad track for purposes of the basis adjustment must be the same as the

definition used for determining QRTME. Limiting the definition of railroad track under the basis adjustment rule to rails, ties, ballast, and other track materials is inconsistent with the intent of the definition of railroad track on which expenditures may qualify as QRTME. The definition of railroad track for which expenditures may qualify as QRTME was intended by Congress to be expansive and includes bridges and other related track structures.

Commentators further suggested that the definition of railroad track under section 45G(e)(3) should not include intangibles. All or some of the QRTME paid or incurred by an eligible taxpayer during the taxable year may be required to be capitalized under section 263(a) as a tangible asset or as an intangible asset for improvements to another taxpayer's real property depending upon whether the eligible taxpayer owns (leases) the railroad track and improvements or not. (See, for example, §1.263(a)–4(d)(8), which generally requires capitalization of amounts paid or incurred by a taxpayer to produce or improve real property owned by another.) Regardless of whether an asset created by QRTME is tangible railroad track owned by the taxpayer, leasehold improvement to railroad track, or intangible railroad track for improvements to another taxpayer's real property, capitalization of the QRTME creates the basis in railroad track that must be reduced under section 45G(e)(3) if the RTMC is claimed on such expenditures. The rules requiring capitalization of amounts paid or incurred by a taxpayer to produce or improve real property owned by another under section 263(a) were prescribed prior to the enactment of section 45G. The provision in these final regulations that specifically references intangible assets is a reminder that, for purposes of section 45G(e)(3), it is possible that the basis that must be reduced is the basis of an intangible asset.

Coordination with Section 61

The temporary regulations, as corrected, do not contain a specific provision relating to the application of section 61, because such a provision would need to be placed in regulations under section 61. Section 1.45G–1T was never intended to provide rules for determining gross income under section 61. Section 61 and its regulations apply to certain transactions involving section 45G regardless of these regulations or the temporary regulations, and additional regulations under section 61 are not necessary. As stated in the preamble to the temporary regulations, there is no provision in section 45G that prevents the application of section 61 to certain transactions under section 45G. Taxpayers are reminded, therefore, that certain transactions under section 45G may generate gross income.

Other Changes

The final regulations contain other various changes that clarify the application of section 45G.

Effective Dates

Section 245(a) of the AJCA provides that section 45G applies to taxable years beginning after December 31, 2004 and beginning before January 1, 2008. Section 423(b) of the TRHCA provides that the amendments made by section 423(a) to section 45G(d) take effect as if included in section 245(a) of the AJCA. The final regulations provide that §1.45G–1 is effective for taxable years ending on or after September 7, 2006 (the effective date of §1.45G–1T). Section 1.45G–1(g)(2) provides that a taxpayer may apply §1.45G–1 to taxable years beginning after December 31, 2004, and ending before September 7, 2006, provided that the taxpayer applies all provisions in §1.45G–1 to the taxable year.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.45G–0 is added to read as follows:

§1.45G–0 Table of contents for the railroad track maintenance credit rules.

This section lists the table of contents for §1.45G–1.

§1.45G–1 Railroad track maintenance credit.

(a) In general.
(b) Definitions.
(1) Class II railroad and Class III railroad.
(2) Eligible railroad track.
(3) Eligible taxpayer.
(4) Qualifying railroad structure.
(5) Qualified railroad track maintenance expenditures.
(6) Rail facilities.
(7) Railroad-related property.
(8) Railroad-related services.
(9) Railroad track.
(10) Form 8900.
(11) Examples.
(c) Determination of amount of railroad track maintenance credit for the taxable year.
(1) General amount.
(2) Limitation on the credit.
(i) Eligible taxpayer is a Class II railroad or Class III railroad.
(ii) Eligible taxpayer is not a Class II railroad or Class III railroad.

(iii) No carryover of amount that exceeds limitation.

(3) Determination of amount of QRTME paid or incurred.

(i) In general.

(ii) Effect of reimbursements received from persons other than a Class II or Class III railroad.

(4) Examples.

(d) Assignment of track miles.

(1) In general.

(2) Assignment eligibility.

(3) Effective date of assignment.

(4) Assignment information statement.

(i) In general.

(ii) Assignor.

(iii) Assignee.

(iv) Special rule for returns filed prior to November 9, 2007.

(5) Special rules.

(i) Effect of subsequent dispositions of eligible railroad track during the assignment year.

(ii) Effect of multiple assignments of eligible railroad track miles during the same taxable year.

(6) Examples.

(e) Adjustments to basis.

(1) In general.

(2) Basis adjustment made to railroad track.

(3) Examples.

(f) Controlled groups.

(1) In general.

(2) Definitions.

(i) Trade or business.

(ii) Group and controlled group.

(iii) Group credit.

(iv) Consolidated group.

(v) Credit year.

(3) Computation of the group credit.

(4) Allocation of the group credit.

(i) In general.

(ii) Stand-alone entity credit.

(5) Special rules for consolidated groups.

(i) In general.

(ii) Special rule for allocation of group credit among consolidated group members.

(6) Tax accounting periods used.

(i) In general.

(ii) Special rule when timing of QRTME is manipulated.

(7) Membership during taxable year in more than one group.

(8) Intra-group transactions.

(i) In general.

(ii) Payment for QRTME.

(g) Effective/applicability date.

(1) In general.

(2) Taxable years ending before September 7, 2006.

(3) Special rules for returns filed prior to November 9, 2007.

§1.45G–0T [Removed]

Par. 3. Section 1.45G–0T is removed.

Par. 4. Section 1.45G–1 is added to read as follows:

§1.45G–1 Railroad track maintenance credit.

(a) *In general.* For purposes of section 38, the railroad track maintenance credit (RTMC) for qualified railroad track maintenance expenditures (QRTME) paid or incurred by an eligible taxpayer during the taxable year is determined under this section. A taxpayer claiming the RTMC must do so by filing Form 8900, "*Qualified Railroad Track Maintenance Credit*," with its timely filed (including extensions) Federal income tax return for the taxable year the RTMC is claimed. Paragraph (b) of this section provides definitions of terms. Paragraph (c) of this section provides rules for computing the RTMC, including rules regarding limitations on the amount of the credit. Paragraph (d) of this section provides rules for assigning miles of railroad track. Paragraph (e) of this section contains rules for adjusting basis for the amount of the RTMC claimed by an eligible taxpayer. Paragraph (f) of this section contains rules for computing the amount of the RTMC in the case of a controlled group, and for the allocation of the group credit among members of the controlled group.

(b) *Definitions.* For purposes of section 45G and this section, the following definitions apply:

(1) *Class II railroad and Class III railroad* have the respective meanings given to these terms by the Surface Transportation Board (STB) without regard to the controlled group rules under section 45G(e)(2).

(2) *Eligible railroad track* is railroad track (as defined in paragraph (b)(9) of this section) located within the United States that is owned or leased by a Class II railroad or Class III railroad at the close of its taxable year. For purposes of section 45G and this section, a Class II railroad or Class III railroad owns railroad track if the railroad track is subject to the allowance for depreciation under section 167 by the Class II railroad or Class III railroad.

(3) *Eligible taxpayer* is—

(i) A Class II railroad or Class III railroad during the taxable year;

(ii) Any person that transports property using the rail facilities (as defined in paragraph (b)(6) of this section) of a Class II railroad or Class III railroad during the taxable year, but only is an eligible taxpayer with respect to the miles of eligible railroad track assigned to the person for that taxable year by that Class II railroad or Class III railroad under paragraph (d) of this section; or

(iii) Any person that furnishes railroad-related property (as defined in paragraph (b)(7) of this section) or railroad-related services (as defined in paragraph (b)(8) of this section), to a Class II railroad or Class III railroad during the taxable year, but only is an eligible taxpayer with respect to the miles of eligible railroad track assigned to the person for that taxable year by that Class II railroad or Class III railroad under paragraph (d) of this section.

(4) *Qualifying railroad structure* is property located within the United States that is described in the following STB property accounts in 49 CFR Part 1201, Subpart A:

(i) Property Account 3, Grading.

(ii) Property Account 4, Other right-of-way expenditures.

(iii) Property Account 5, Tunnels and subways.

(iv) Property Account 6, Bridges, trestles, and culverts.

(v) Property Account 7, Elevated structures.

(vi) Property Account 8, Ties.

(vii) Property Account 9, Rails and other track material.

(viii) Property Account 11, Ballast.

(ix) Property Account 13, Fences, snowsheds, and signs.

(x) Property Account 27, Signals and interlockers.

(xi) Property Account 39, Public improvements; construction.

(5) *Qualified railroad track maintenance expenditures (QRTME)* are expenditures for maintaining, repairing, and improving qualifying railroad structure

(as defined in paragraph (b)(4) of this section) that is owned or leased as of January 1, 2005, by a Class II railroad or Class III railroad. These expenditures may or may not be chargeable to a capital account.

(6) *Rail facilities* of a Class II railroad or Class III railroad are railroad yards, tracks, bridges, tunnels, wharves, docks, stations, and other related assets that are used in the transport of freight by a railroad and that are owned or leased by the Class II railroad or Class III railroad.

(7) *Railroad-related property* is property that is provided directly to, and is unique to, a railroad and that, in the hands of a Class II railroad or Class III railroad, is described in—

(i) The following STB property accounts in 49 CFR Part 1201, Subpart A:

(A) Property Account 3, Grading;

(B) Property Account 5, Tunnels and subways;

(C) Property Account 22, Storage warehouses; and

(ii) Asset classes 40.1 through 40.54 in the guidance issued by the Internal Revenue Service under section 168(i)(1) (for further guidance, for example, see Rev. Proc. 87–56, 1987–2 C.B. 674, and §601.601(d)(2)(ii)(*b*) of this chapter), except that any office building, any passenger train car, and any miscellaneous structure if such structure is not provided directly to, and is not unique to, a railroad are excluded from the definition of railroad-related property.

(8) *Railroad-related services* are services that are provided directly to, and are unique to, a railroad and that relate to railroad shipping, loading and unloading of railroad freight, or repairs of rail facilities (as defined in paragraph (b)(6) of this section) or railroad-related property (as defined in paragraph (b)(7) of this section). Examples of railroad-related services are the transport of freight by rail; the loading and unloading of freight transported by rail; railroad bridge services; railroad track construction; providing railroad track material or equipment; locomotive leasing or rental; maintenance of railroad's right-of-way (including vegetation control); piggyback trailer ramping; rail deramping services; and freight train cars repair services. Examples of services that are not railroad-related services are general business services, such as, accounting and bookkeeping, marketing, legal services; janitorial services; office building rental; banking services (including financing of railroad-related property); and purchasing of, or services performed on, property not described in paragraph (b)(7) of this section.

(9) Except as provided in paragraph (e)(2) of this section, *railroad track* is property described in STB property accounts 8 (ties), 9 (rails and other track material), and 11 (ballast) in 49 CFR part 1201, Subpart A. *Double track* is treated as multiple lines of railroad track, rather than as a single line of railroad track. Thus, one mile of single track is one mile, but one mile of double track is two miles.

(10) *Form 8900*. If Form 8900 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

(11) *Examples*. The application of this paragraph (b) is illustrated by the following examples. In all examples, the taxpayers use a calendar taxable year, and are not members of a controlled group.

Example 1. A is a manufacturer that in 2006, transports its products by rail using the railroad tracks owned by B, a Class II railroad that owns 500 miles of railroad track within the United States on December 31, 2006. B properly assigns for purposes of section 45G 100 miles of eligible railroad track to A in 2006. A is an eligible taxpayer for 2006 with respect to the 100 miles of eligible railroad track.

Example 2. C is a bank that loans money to several Class III railroads. In 2006, C loans money to D, a Class III railroad, who in turn uses the loan proceeds to purchase track material. Because providing loans is not a service that is unique to a railroad, C is not providing railroad-related services and, thus, C is not an eligible taxpayer, even if D assigns miles of eligible railroad track to C for purposes of section 45G.

Example 3. E leases locomotives directly to Class I, Class II, and Class III railroads. In 2006, E leases locomotives to F, a Class II railroad that owns 200 miles of railroad track within the United States on December 31, 2006. F properly assigns for purposes of section 45G 200 miles of eligible railroad track to E. Because locomotives are property that is unique to a railroad, and E leases these locomotives directly to F in 2006, E is an eligible taxpayer for 2006 with respect to the 200 miles of eligible railroad track assigned to E by F.

Example 4. The facts are the same as in *Example 3*, except that E leases passenger trains, not locomotives, to F. Because passenger trains are not railroad-related property for purposes of section 45G, E is not an eligible taxpayer even if F assigns miles of eligible railroad track to E for purposes of section 45G.

(c) *Determination of amount of railroad track maintenance credit for the taxable year*—(1) *General amount.* Except as provided in paragraph (c)(2) of this section, for purposes of section 38, the RTMC determined under section 45G(a) for the taxable year is equal to 50 percent of the QRTME paid or incurred (as determined under paragraph (c)(3) of this section) by an eligible taxpayer during the taxable year.

(2) *Limitation on the credit*—(i) *Eligible taxpayer is a Class II railroad or Class III railroad.* If an eligible taxpayer is a Class II railroad or Class III railroad, the RTMC determined under paragraph (c)(1) of this section for the Class II railroad or Class III railroad for any taxable year must not exceed $3,500 multiplied by the sum of—

(A) The number of miles of eligible railroad track owned or leased by the Class II railroad or Class III railroad, reduced by the number of miles of eligible railroad track assigned under paragraph (d) of this section by the Class II railroad or Class III railroad to another eligible taxpayer for that taxable year; and

(B) The number of miles of eligible railroad track owned or leased by another Class II railroad or Class III railroad that are assigned under paragraph (d) of this section to the Class II railroad or Class III railroad for the taxable year.

(ii) *Eligible taxpayer is not a Class II railroad or Class III railroad.* If an eligible taxpayer is not a Class II railroad or Class III railroad, the RTMC determined under paragraph (c)(1) of this section for the eligible taxpayer for any taxable year must not exceed $3,500 multiplied by the number of miles of eligible railroad track assigned under paragraph (d) of this section by a Class II railroad or Class III railroad to the eligible taxpayer for the taxable year.

(iii) *No carryover of amount that exceeds limitation.* Amounts that exceed the limitation under paragraph (c)(2)(i) of this section or paragraph (c)(2)(ii) of this section, may never be carried over to another taxable year.

(3) *Determination of amount of QRTME paid or incurred*—(i) *In general.* The term *paid or incurred* means, in the case of a taxpayer using an accrual method of accounting, a liability incurred (within the meaning of §1.446–1(c)(1)(ii)). A liability may not be taken into account under section 45G and this section prior to the taxable year during which the liability is incurred. Any amount that an eligible tax-

payer (assignee) pays a Class II railroad or Class III railroad (assignor) in exchange for an assignment of one or more miles of eligible railroad track under paragraph (d) of this section, is treated, for purposes of this section, as QRTME paid or incurred by the assignee, and not by the assignor, at the time and to the extent the assignor pays or incurs QRTME.

(ii) *Effect of reimbursements received from persons other than a Class II or Class III railroad.* The amount of QRTME treated as paid or incurred during the taxable year by an eligible taxpayer under paragraphs (b)(3)(ii) and (iii) of this section shall be reduced by any amount to which the eligible taxpayer is entitled to be reimbursed, directly or indirectly, from persons other than a Class II or Class III railroad.

(4) *Examples.* The application of this paragraph (c) is illustrated by the following examples. In all examples, the taxpayers use an accrual method of accounting and a calendar taxable year, and are not members of a controlled group.

Example 1. Computation of RTMC; section 45G credit limitation is not exceeded. (i) G is a Class II railroad that owns or has leased to it 1,000 miles of railroad track within the United States on December 31, 2006. H is a manufacturer that in 2006, transports its products by rail using the rail facilities of G. In 2006, for purposes of section 45G, G assigns 100 miles of eligible railroad track to H and does not make any other assignments of railroad track miles. H did not receive any other assignments of railroad track miles in 2006. During 2006, G incurred QRTME in the amount of $2.5 million and H incurred QRTME in the amount of $200,000.

(ii) For 2006, G determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $1,250,000 (50% multiplied by $2,500,000 QRTME incurred by G during 2006). G further determines G's credit limitation under paragraph (c)(2)(i) of this section for 2006 to be $3,150,000 ($3,500 multiplied by 900 miles of eligible railroad track (1,000 miles owned by, or leased to, G on December 31, 2006, less 100 miles assigned by G to H in 2006)). Because G's tentative amount of RTMC does not exceed G's credit limitation amount for 2006, G may claim a RTMC for 2006 in the amount of $1,250,000.

(iii) For 2006, H determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $100,000 (50% multiplied by $200,000 QRTME incurred by H during 2006). H further determines H's credit limitation under paragraph (c)(2)(ii) of this section for 2006 to be $350,000 ($3,500 multiplied by 100 miles of eligible railroad track assigned by G to H in 2006). Because H's tentative amount of RTMC does not exceed H's credit limitation amount for 2006, H may claim a RTMC in the amount of $100,000.

Example 2. Computation of RTMC; section 45G credit limitation is exceeded. (i) The facts are the same as in *Example 1*, except that G assigned for purposes of section 45G only 50 miles of railroad track to H in 2006 and, during 2006, H incurred QRTME in the amount of $400,000.

(ii) For 2006, G determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $1,250,000 (50% multiplied by $2,500,000 QRTME incurred by G during 2006). G further determines G's credit limitation under paragraph (c)(2)(i) of this section for 2006 to be $3,325,000 ($3,500 multiplied by 950 miles of eligible railroad track (1,000 miles owned by, or leased to, G on December 31, 2006, less 50 miles assigned by G to H in 2006)). Because G's tentative amount of RTMC does not exceed G's credit limitation amount for 2006, G may claim a RTMC in the amount of $1,250,000

(iii) For 2006, H determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $200,000 (50% multiplied by $400,000 QRTME incurred by H during 2006). H further determines H's credit limitation under paragraph (c)(2)(ii) of this section for 2006 to be $175,000 ($3,500 multiplied by 50 miles of eligible railroad track assigned by G to H in 2006). Because H's tentative amount of RTMC exceeds H's credit limitation amount for 2006, H may claim a RTMC in the amount of $175,000 (the credit limitation amount). Under paragraph (c)(2)(iii) of this section, there is no carryover of the $25,000 (the tentative amount of $200,000 less the credit limitation amount of $175,000) that exceeds the limitation.

Example 3. Railroad track miles assigned for payment. (i) J is a Class II railroad that owns or has leased to it 1,000 miles of railroad track within the United States on December 31, 2006. K is a corporation that sells ties, ballast, and other track material to Class I, Class II, and Class III railroads. During 2006, K sold these items to J and J incurred QRTME in the amount of $1 million. Also, on December 6, 2006, J assigned for purposes of section 45G 150 miles of eligible railroad track to K and K paid J $800,000 for that assignment. K did not pay or incur any other QRTME during 2006.

(ii) For 2006, in accordance with paragraph (c)(3)(ii) of this section, J is treated as having incurred QRTME in the amount of $200,000 ($1 million QRTME actually incurred by J less the $800,000 paid by K to J for the assignment of the railroad track miles in 2006). For 2006, J determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $100,000 (50% multiplied by $200,000 QRTME treated as incurred by J during 2006). J further determines J's credit limitation amount under paragraph (c)(2)(i) of this section for 2006 to be $2,975,000 ($3,500 multiplied by 850 miles of eligible railroad track (1,000 miles owned by, or leased to, J on December 31, 2006, less 150 miles assigned by J to K in 2006)). Because J's tentative amount of RTMC does not exceed J's credit limitation amount for 2006, J may claim a RTMC in the amount of $100,000.

(iii) For 2006, K is an eligible taxpayer because, during 2006, K provided railroad-related property to J and received an assignment of eligible railroad track miles from J. Under paragraph (c)(3)(ii) of this section, K is treated as having incurred QRTME in the amount of $800,000 (the amount paid by K to J for the assignment of the railroad track miles in 2006). For 2006, K determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $400,000 (50% multiplied by $800,000 QRTME treated as incurred by K during 2006). K further determines K's credit limitation amount under paragraph (c)(2)(ii) of this section for 2006 to be $525,000 ($3,500 multiplied by 150 miles of eligible railroad track assigned by J in 2006). Because K's tentative amount of RTMC does not exceed K's credit limitation amount for 2006, K may claim a RTMC in the amount of $400,000.

(iv) The results in this *Example 3* would be the same if K sold the ties, ballast, and other track material with a fair market value of $1 million to J for $200,000 in exchange for the assignment by J of 150 miles of eligible railroad track to K.

Example 4. Reimbursement of QRTME. (i) L is a Class III railroad that owns or has leased to it 500 miles of railroad track within the United States on December 31, 2006. M is a manufacturer that in 2006 transports its products by rail using the rail facilities of L. During 2006, L did not incur any QRTME. Also, in 2006, L assigned for purposes of section 45G 200 miles of eligible railroad track to M and agreed to reduce L's freight shipping rates to M by $250,000 in exchange for M upgrading these railroad track miles. Consequently, during 2006, M incurred QRTME of $500,000 to upgrade these 200 miles of railroad track and L reduced L's freight shipping rates for M by $250,000.

(ii) For 2006, M is an eligible taxpayer because, during 2006, M transported property using the rail facilities of L and received an assignment of eligible railroad track miles from L. The amount of QRTME paid or incurred by M during 2006 is $500,000 and is not reduced by the reimbursement of $250,000 by L to M because, under paragraph (c)(3)(ii) of this section, QRTME is not reduced by reimbursements from Class II or Class III railroads. For 2006, M determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $250,000 (50% multiplied by $500,000 QRTME incurred by M during 2006). M further determines M's credit limitation amount under paragraph (c)(2)(ii) of this section for 2006 to be $700,000 ($3,500 multiplied by 200 miles of eligible railroad track assigned by L to M in 2006). Because M's tentative amount of RTMC does not exceed M's credit limitation amount for 2006, M may claim a RTMC in the amount of $250,000.

(d) *Assignment of track miles*—(1) *In general.* An assignment of any mile of eligible railroad track under this paragraph (d) is a designation by a Class II railroad or Class III railroad that is made solely for purposes of section 45G and this section of a specific number of miles of eligible railroad track as being assigned to another eligible taxpayer for a taxable year. A designation must be in writing and must include the name and taxpayer identification number of the assignee, and the information required under the rules of paragraph (d)(4)(iii)(B) of this section. A designation requires no transfer of legal title or other *indicia* of ownership of the eligible railroad track, and need not specify the location of any assigned mile of eligible rail-

road track. Further, an assigned mile of eligible railroad track need not correspond to any specific mile of eligible railroad track with respect to which the eligible taxpayer actually pays or incurs the QRTME.

(2) *Assignment eligibility.* Only a Class II railroad or Class III railroad may assign a mile of eligible railroad track. If a Class II railroad or Class III railroad assigns a mile of eligible railroad track to an eligible taxpayer, the assignee is not permitted to reassign any mile of eligible railroad track to another eligible taxpayer. The maximum number of miles of eligible railroad track that may be assigned by a Class II railroad or Class III railroad for any taxable year is its total miles of eligible railroad track less the miles of eligible railroad track that the Class II railroad or Class III railroad retains for itself in determining its RTMC for the taxable year.

(3) *Effective date of assignment.* If a Class II railroad or Class III railroad assigns a mile of eligible railroad track, the assignment is treated as being made by the Class II railroad or Class III railroad at the close of its taxable year in which the assignment was made. With respect to the assignee, the assignment of a mile of eligible railroad track is taken into account for the taxable year of the assignee that includes the date the assignment is treated as being made by the assignor Class II railroad or Class III railroad under this paragraph (d)(3).

(4) *Assignment information statement*—(i) *In general.* A taxpayer must file Form 8900, "*Qualified Railroad Track Maintenance Credit*," with its timely filed (including extensions) Federal income tax return for the taxable year for which the taxpayer assigns any mile of eligible railroad track, even if the taxpayer is not itself claiming the RTMC for that taxable year.

(ii) *Assignor.* Except as provided in paragraph (d)(4)(iv) of this section, a Class II railroad or Class III railroad (assignor) that assigns one or more miles of eligible railroad track during a taxable year to one or more eligible taxpayers must attach to the assignor's Form 8900 for that taxable year an information statement providing—

(A) The name and taxpayer identification number of each assignee;

(B) The total number of miles of the assignor's eligible railroad track;

(C) The number of miles of eligible railroad track assigned by the assignor to each assignee for the taxable year; and

(D) The total number of miles of eligible railroad track assigned by the assignor to all assignees for the taxable year.

(iii) *Assignee.* Except as provided in paragraph (d)(4)(iv) of this section, an eligible taxpayer (assignee) that has received an assignment of miles of eligible railroad track during its taxable year from a Class II railroad or Class III railroad, and that claims the RTMC for that taxable year, must attach to the assignee's Form 8900 for that taxable year a statement—

(A) Providing the total number of miles of eligible railroad track assigned to the assignee for the assignee's taxable year; and

(B) Attesting that the assignee has in writing, and has retained as part of the assignee's records for purposes of §1.6001–1(a), the following information from each assignor:

(*1*) The name and taxpayer identification number of each assignor.

(*2*) The date of each assignment made by each assignor (as determined under paragraph (d)(3) of this section) to the assignee;

(*3*) The number of miles of eligible railroad track assigned by each assignor to the assignee for the assignee's taxable year.

(iv) *Special rules for returns filed prior to November 9, 2007.* If an eligible taxpayer's Federal income tax return for a taxable year beginning after December 31, 2004, and ending before November 9, 2007, was filed before December 13, 2007, and the eligible taxpayer is not filing an amended Federal income tax return for that taxable year pursuant to paragraph (g)(2) of this section before the eligible taxpayer's next filed original Federal income tax return, and the eligible taxpayer wants to apply paragraph (g)(2) of this section but did not include with that return the information specified in paragraph (d)(4)(ii) or (iii) of this section, as applicable, the eligible taxpayer must attach a statement containing the information specified in paragraph (d)(4)(ii) or (iii) of this section, as applicable, to either—

(A) The eligible taxpayer's next filed original Federal income tax return; or

(B) The eligible taxpayer's amended Federal income tax return that is filed pursuant to paragraph (g)(2) of this section, provided that amended Federal income tax return is filed by the eligible taxpayer before its next filed original Federal income tax return.

(5) *Special rules*—(i) *Effect of subsequent dispositions of eligible railroad track during the assignment year.* If a Class II railroad or Class III railroad assigns one or more miles of eligible railroad track that it owned or leased as of the actual date of the assignment, but does not own or lease any eligible railroad track at the close of the taxable year in which the assignment is made by the Class II railroad or Class III railroad, the assignment is not valid for that taxable year for purposes of section 45G and this section.

(ii) *Effect of multiple assignments of eligible railroad track miles during the same taxable year.* If a Class II railroad or Class III railroad assigns more miles of eligible railroad track than it owned or leased as of the close of the taxable year in which the assignment is made by the Class II railroad or Class III railroad, the assignment is valid for purposes of section 45G and this section only with respect to the name of the assignee and the number of miles listed by the assignor Class II railroad or Class III railroad on the statement required under paragraph (d)(4)(ii) of this section and only to the extent of the maximum miles of eligible railroad track that may be assigned by the assignor Class II railroad or Class III railroad as determined under paragraph (d)(2) of this section. If the total number of miles on this statement exceeds the maximum miles of eligible railroad track that may be assigned by the assignor Class II railroad or Class III railroad (as determined under paragraph (d)(2) of this section), the total number of miles on the statement shall be reduced by the excess amount of miles. This reduction is allocated among each assignee listed on the statement in proportion to the total number of miles listed on the statement for that assignee.

(6) *Examples.* The application of this paragraph (d) is illustrated by the following examples. In none of the examples are the taxpayers members of a controlled group:

Example 1. Assignor and assignee have the same taxable year. (i) N, a calendar year taxpayer, is a Class II railroad that owns 500 miles of railroad track within the United States on December 31, 2006. O, a calendar year taxpayer, is not a railroad, but is a taxpayer that provides railroad-related property to N

during 2006. On November 7, 2006, N assigns for purposes of section 45G 300 miles of eligible railroad track to O. O receives no other assignment of eligible railroad track in 2006. O pays or incurs QRTME in the amount of $100,000 in November 2006, and $50,000 in February 2007. N and O each file Form 8900 with their timely filed Federal income tax returns for 2006 and attach the statement required by paragraph (d)(4)(ii) and (iii), respectively, of this section reporting the assignment of the 300 miles of eligible railroad track to O.

(ii) The assignment of the 300 miles of eligible railroad track made by N to O on November 7, 2006, is treated as made on December 31, 2006 (at the close of the N's taxable year). Consequently, the assignment is taken into account by O for O's taxable year ending on December 31, 2006. For 2006, O is an eligible taxpayer because, during 2006, O provides railroad-related property to N and receives an assignment of 300 eligible railroad track miles from N. For 2006, O determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $50,000 (50% multiplied by $100,000 QRTME paid or incurred by O during 2006). O further determines the credit limitation amount under paragraph (c)(2)(i) of this section for 2006 to be $1,050,000 ($3,500 multiplied by 300 miles of eligible railroad track assigned by N to O on December 31, 2006). Because O's tentative amount of RTMC does not exceed O's credit limitation amount for 2006, O may claim a RMTC for 2006 in the amount of $50,000.

Example 2. Assignor and assignee have different taxable years. (i) The facts are the same as in *Example 1*, except that O's taxable year ends on March 31.

(ii) The assignment of the 300 miles of eligible railroad track made by N to O on November 7, 2006, is treated as made on December 31, 2006. As a result, the assignment is taken into account by O for O's taxable year ending on March 31, 2007. Thus, for the taxable year ending on March 31, 2007, O determines the tentative amount of RMTC under paragraph (c)(1) of this section to be $75,000 (50% multiplied by $150,000 QRTME incurred by O during its taxable year ending March 31, 2007). Because O's tentative amount of RTMC does not exceed O's credit limitation amount for the taxable year ending March 31, 2007, O may claim a RMTC for the taxable year ending March 31, 2007, in the amount of $75,000.

Example 3. Assignment location differs from QRTME location. (i) P, a calendar-year taxpayer, is a Class III railroad that owns or has leased to it 200 miles of railroad track within the United States on December 31, 2006. P owns 50 miles of this railroad track and leases 150 miles of this railroad track from Q, a Class I railroad. On February 8, 2006, P assigns for purposes of section 45G 50 miles of eligible railroad track to R. R is not a railroad, but is a taxpayer that ships products using the 50 miles of eligible railroad track owned by P, and R paid $100,000 in 2006 to P to enable P to upgrade these 50 miles of eligible railroad track. In March 2006, P also assigns for purposes of section 45G 150 miles of eligible railroad track to S. S is not a railroad, but is a taxpayer that provides railroad-related property to P, and S paid $400,000 to P to enable P to upgrade P's 200 miles of eligible railroad track. For 2006, P pays or incurs QRTME in the amount of $500,000 to upgrade the 150 miles of eligible railroad track that it leases from Q and pays or incurs no QRTME on the 50 miles of eligible railroad track that it owns. For 2006, P receives no other assignment of eligible railroad track miles and did not retain any eligible railroad track miles for itself. Also, R and S do not pay or incur any other amounts that would qualify as QRTME during 2006. P, R, and S each file Form 8900 with their timely filed Federal income tax returns for 2006 and attach the statement required by paragraph (d)(4)(ii) or (iii) of this section, whichever applies, reporting the assignment of eligible railroad track by P to R or S in 2006.

(ii) For 2006, in accordance with paragraph (c)(3)(ii) of this section, P is treated as having incurred QRTME in the amount of $0 ($500,000 QRTME actually incurred by P less the $100,000 paid by R to P for the assignment of the 50 miles of eligible railroad track and the $400,000 paid by S to P for the assignment of the 150 miles of eligible railroad track). Further, P assigned all of its eligible railroad track miles to R and S for 2006. Accordingly, for 2006, P may not claim any RTMC.

(iii) For 2006, R is an eligible taxpayer because, during 2006, R ships property using the rail facilities of P and receives an assignment of 50 eligible railroad track miles from P. In accordance with paragraph (c)(3)(ii) of this section, R is treated as having incurred QRTME in the amount of $100,000 (the amount paid by R to P for the assignment of the eligible railroad track miles in 2006) even though no work was performed on the 50 miles of eligible railroad track that was assigned by P to R. For 2006, R determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $50,000 (50% multiplied by $100,000 QRTME treated as incurred by R during 2006). R further determines the credit limitation amount under paragraph (c)(2)(ii) of this section to be $175,000 ($3,500 multiplied by 50 miles of eligible railroad track assigned by P to R in 2006). Because R's tentative amount of RTMC does not exceed R's credit limitation amount for 2006, R may claim a RTMC for 2006 in the amount of $50,000.

(iv) For 2006, S is an eligible taxpayer because, during 2006, S provides railroad-related property to P and receives an assignment of 150 eligible railroad track miles from P. In accordance with paragraph (c)(3)(ii) of this section, S is treated as having incurred QRTME in the amount of $400,000 (amount paid by S to P for the assignment of the eligible railroad track miles in 2006). For 2006, S determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $200,000 (50% multiplied by $400,000 QRTME treated as incurred by S during 2006). S further determines the credit limitation amount under paragraph (c)(2)(ii) of this section to be $525,000 ($3,500 multiplied by 150 miles of eligible railroad track assigned by P to S in 2006). Because S's tentative amount of RTMC does not exceed S's credit limitation amount for 2006, S may claim a RTMC for 2006 in the amount of $200,000.

Example 4. Multiple assignments of track miles. (*i*) T, a calendar-year taxpayer, is a Class III railroad that owns or has leased to it 200 miles of railroad track within the United States on December 31, 2006. T owns 75 miles of this railroad track and leases 125 miles of this railroad track from U, a Class I railroad. V and W are not railroads, but are both taxpayers that provide railroad-related services to T during 2006. On January 15, 2006, T assigns for purposes of section 45G 200 miles of eligible railroad track to V. V agrees to incur, in 2006, $1.4 million of QRTME to upgrade a portion of/segment of these 200 miles of eligible railroad track. Due to unexpected financial difficulties, V only incurs $250,000 of QRTME during 2006 and on May 15, 2006, T learns that V is unable to incur the remainder of the QRTME. On June 15, 2006, T assigns for purposes of section 45G the 200 miles of railroad track to W. In 2006, W incurs $1,100,000 of QRTME to upgrade a portion of/segment of the railroad track. For 2006, T receives no other assignment of eligible railroad track miles and did not retain any eligible railroad track miles for itself. V and W do not receive any other assignments of miles of eligible railroad track miles from a Class II railroad or Class III railroad during 2006. T and W each file Form 8900 with their timely filed Federal income tax returns for 2006, and attach the statement required by paragraph (d)(4)(ii) and (iii), respectively, of this section, reporting the assignment of 200 miles of eligible railroad track to W.

(ii) Because T did not retain any miles of eligible railroad track for itself for 2006, the maximum miles of eligible railroad track that may be assigned by T for 2006 is 200 miles pursuant to paragraph (d)(2) of this section. On the statement required by paragraph (d)(4)(ii) of this section, T assigned a total of 200 miles of eligible railroad track to W. Consequently, because T did not list V as an assignee on T's statement required by paragraph (d)(4)(ii) of this section, V did not receive an assignment of eligible railroad track miles from T during 2006 and V is not an eligible taxpayer for 2006. Thus, for 2006, V may not claim any RTMC even though V incurred QRTME in the amount of $250,000.

(iii) For 2006, W is an eligible taxpayer because, during 2006, W provides railroad-related services to T and receives an assignment of 200 eligible railroad track miles from T. W determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $550,000 (50% multiplied by $1,100,000 QRTME incurred by W during 2006). W further determines the credit limitation amount under paragraph (c)(2)(ii) of this section to be $700,000 ($3,500 multiplied by the 200 miles of eligible railroad track assigned by T to W in 2006). Because W's tentative amount of RTMC does not exceed W's credit limitation amount for 2006, W may claim a RTMC for 2006 in the amount of $550,000.

Example 5. Multiple assignments of track miles. (i) Same facts as in *Example 4*, except T, to its Form 8900 for 2006, attaches the statement required by paragraph (d)(4)(ii) of this section assigning 200 miles of eligible railroad track to W and 200 miles of eligible railroad track to V.

(ii) Because T did not retain any miles of eligible railroad track for itself for 2006, the maximum miles of eligible railroad track that may be assigned by T for 2006 is 200 miles pursuant to paragraph (d)(2) of this section. However, on the statement required by paragraph (d)(4)(ii) of this section, T assigned a total of 400 miles of eligible railroad track (200 miles to W and 200 miles to V). Consequently, the 400 miles of eligible railroad track on this statement must be reduced to the 200 maximum miles of eligible railroad track available for assignment for 2006. Because the statement reports 200 miles of eligible railroad track assigned to each W and V, the reduction of 200 miles (400 total miles of eligible railroad track on the statement less 200 maximum miles of eligible railroad

track available for assignment) is allocated *pro-rata* between W and V and, therefore, 100 miles each to W and V. Thus, pursuant to paragraph (d)(5)(ii) of this section, the number of miles of eligible railroad track assigned by T to W and V for 2006 is 100 miles each.

(iii) For 2006, V is an eligible taxpayer because, during 2006, V provides railroad-related services to T and receives an assignment of 100 eligible railroad track miles from T. V determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $125,000 (50% multiplied by $250,000 QRTME incurred by V during 2006). V further determines the credit limitation amount under paragraph (c)(2)(ii) of this section to be $350,000 ($3,500 multiplied by the 100 miles of eligible railroad track assigned by T to V in 2006). Because V's tentative amount of RTMC does not exceed W's credit limitation amount for 2006, V may claim a RTMC for 2006 in the amount of $125,000.

(iv) For 2006, W is an eligible taxpayer because, during 2006, W provides railroad-related services to T and receives an assignment of 100 eligible railroad track miles from T. W determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $550,000 (50% multiplied by $1,100,000 QRTME incurred by W during 2006). W further determines the credit limitation amount under paragraph (c)(2)(ii) of this section to be $350,000 ($3,500 multiplied by the 100 miles of eligible railroad track assigned by T to W in 2006). Because W's tentative amount of RTMC exceeds W's credit limitation amount for 2006, W may claim a RTMC for 2006 in the amount of $350,000 (the credit limitation). There is no carryover of the amount of $200,000 (the tentative amount of $550,000 less the credit limitation amount of $350,000).

(e) *Adjustments to basis*—(1) *In general.* All or some of the QRTME paid or incurred by an eligible taxpayer during the taxable year may be required to be capitalized under section 263(a) as a tangible asset or as an intangible asset. See, for example, §1.263(a)–4(d)(8), which requires capitalization of amounts paid or incurred by a taxpayer to produce or improve real property owned by another (except to the extent the taxpayer is selling services at fair market value to produce or improve the real property) if the real property can reasonably be expected to produce significant economic benefits for the taxpayer. The basis of the tangible asset or intangible asset includes the capitalized amount of the QRTME.

(2) *Basis adjustment made to railroad track.* An eligible taxpayer must reduce the adjusted basis of any railroad track with respect to which the eligible taxpayer claims the RTMC. For purposes of section 45G(e)(3) and this paragraph (e)(2), the adjusted basis of any railroad track with respect to which the eligible taxpayer claims the RTMC is limited to the amount of QRTME, if any, that is required to be capitalized into the qualifying railroad structure or an intangible asset. The adjusted basis of the railroad track is reduced by the amount of the RTMC allowable (as determined under paragraph (c) of this section) by the eligible taxpayer for the taxable year, but not below zero. This reduction is taken into account at the time the QRTME is paid or incurred by an eligible taxpayer and before the depreciation deduction with respect to such railroad track is determined for the taxable year for which the RTMC is allowable. If all or some of the QRTME paid or incurred by an eligible taxpayer during the taxable year is capitalized under section 263(a) to more than one asset, whether tangible or intangible (for example, railroad track and bridges), the reduction to the basis of these assets under this paragraph (e)(2) is allocated among each of the assets subject to the reduction in proportion to the unadjusted basis of each asset at the time the QRTME is paid or incurred during that taxable year.

(3) *Examples.* The application of this paragraph (e) is illustrated by the following examples. In each example, all taxpayers use a calendar taxable year, and no taxpayers are members of a controlled group.

Example 1. (i) X is a Class II railroad that owns 500 miles of railroad track within the United States on December 31, 2006. During 2006, X incurs $1 million of QRTME for maintaining this railroad track. X uses the track maintenance allowance method for track structure expenditures (for further guidance, see Rev. Proc. 2002–65, 2002–2 C.B. 700, and §601.601(d)(2)(ii)(*b*) of this chapter). Assume all of the $1 million QRTME is track structure expenditures and none of it was expended for new track structure.

(ii) For 2006, X determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $500,000 (50% multiplied by $1 million QRTME incurred by X during 2006). X further determines the credit limitation amount under paragraph (c)(2)(i) of this section for 2006 to be $1,750,000 ($3,500 multiplied by 500 miles of eligible railroad track). Because X's tentative amount of RTMC does not exceed X's credit limitation amount for 2006, X may claim a RTMC for 2006 in the amount of $500,000.

(iii) Of the $1 million QRTME incurred by X during 2006, X determines under the track maintenance allowance method that $750,000 is the track maintenance allowance under section 162 and $250,000 is the capitalized amount for the track structure. In accordance with paragraph (e)(2) of this section, X reduces the capitalized amount of $250,000 by the RTMC of $500,000 claimed by X for 2006, but not below zero. Thus, the capitalized amount of $250,000 is reduced to zero. X also deducts under section 162 a track maintenance allowance of $750,000 on its 2006 Federal income tax return.

Example 2. (i) Y is a Class II railroad that owns or has leased to it 500 miles of eligible railroad track within the United States on December 31, 2006. Z is not a railroad, but is a taxpayer that, in 2006, transports its products using the rail facilities of Y. In 2006, Y assigns for purposes of section 45G 300 miles of eligible railroad track to Z. Z does not receive any other assignments of eligible railroad track miles in 2006. During 2006, Z incurs QRTME in the amount of $1 million, and Y does not incur any QRTME. Y and Z each file Form 8900 with their timely filed Federal income tax returns for 2006 and attach the statement required by paragraph (d)(4)(ii) and (iii), respectively, of this section reporting the assignment of the 300 miles of eligible railroad track to Z.

(ii) For 2006, Z determines the tentative amount of RTMC under paragraph (c)(1) of this section to be $500,000 (50% multiplied by $1 million QRTME incurred by Z during 2006). Z further determines the credit limitation amount under paragraph (c)(2)(ii) of this section for 2006 to be $1,050,000 ($3,500 multiplied by 300 miles of eligible railroad track assigned by Y to Z in 2006). Because Z's tentative amount of RTMC does not exceed Z's credit limitation amount for 2006, Z may claim a RTMC for 2006 in the amount of $500,000.

(iii) For 2006, Z also must determine the portion of the $1 million QRTME that Z incurs that is required to be capitalized under section 263(a), and the portion that is a section 162 expense. Because Z is not a Class II railroad or Class III railroad, Z cannot use the track maintenance allowance method. Assume that all of the QRTME constitutes an intangible asset under §1.263(a)–4(d)(8) and, therefore, is required to be capitalized by Z under section 263(a) as an intangible asset. In accordance with paragraph (e)(2) of this section, Z reduces the capitalized amount of $1 million by the RTMC of $500,000 claimed by Z for 2006. Thus, the capitalized amount of $1 million for the intangible asset is reduced to $500,000. Further, pursuant to §1.167(a)–3(b)(1)(iv), Z may treat this intangible asset with an adjusted basis of $500,000 as having a useful life of 25 years for purposes of the depreciation allowance under section 167(a).

(f) *Controlled groups*—(1) *In general.* Pursuant to section 45G(e)(2), if an eligible taxpayer is a member of a controlled group of corporations, rules similar to the rules in §1.41–6T apply for determining the amount of the RTMC under section 45G(a) and this section. To determine the amount of RTMC (if any) allowable to a trade or business that at the end of its taxable year is a member of a controlled group, a taxpayer must—

(i) Compute the group credit in the manner described in paragraph (f)(3) of this section; and

(ii) Allocate the group credit among the members of the group in the manner described in paragraph (f)(4) of this section.

(2) *Definitions.* For purposes of section 45G(e)(2) and paragraph (f) of this section—

(i) A *trade or business* is a sole proprietorship, a partnership, a trust, an estate, or a corporation that is carrying on a trade or business (within the meaning of section 162). Any corporation that is a member of a commonly controlled group shall be deemed to be carrying on a trade or business if any other member of that group is carrying on any trade or business;

(ii) *Group* and *controlled group* means a controlled group of corporations, as defined in section 41(f)(5), or a group of trades or businesses under common control. For rules for determining whether trades or businesses are under common control, see §1.52–1 (b) through (g);

(iii) *Group credit* means the RTMC (if any) allowable to a controlled group;

(iv) *Consolidated group* has the meaning set forth in §1.1502–1(h); and

(v) *Credit year* means the taxable year for which the member is computing the RTMC.

(3) *Computation of the group credit.* All members of a controlled group are treated as a single taxpayer for purposes of computing the RTMC. The group credit is computed by applying all of the section 45G computational rules (including the rules set forth in this section) on an aggregate basis.

(4) *Allocation of the group credit*—(i) *In general.* (A) To the extent the group credit (if any) computed under paragraph (f)(3) of this section does not exceed the sum of the stand-alone entity credits of all of the members of a controlled group, computed under paragraph (f)(4)(ii) of this section, such group credit shall be allocated among the members of the controlled group in proportion to the stand-alone entity credits of the members of the controlled group, computed under paragraph (f)(4)(ii) of this section:

$$\text{group credit that does not exceed sum of all the members' stand-alone entity credits} \times \frac{\text{member's stand-alone entity credit}}{\text{Sum of all the members' stand-alone entity credits.}}$$

(B) To the extent that the group credit (if any) computed under paragraph (f)(3) of this section exceeds the sum of the stand-alone entity credits of all of the members of the controlled group, computed under paragraph (f)(4)(ii) of this section, such excess shall be allocated among the members of a controlled group in proportion to the QRTMEs of the members of the controlled group:

$$\text{(group credit less the sum of all the members' stand-alone entity credits)} \times \frac{\text{QRTMEs of members that are eligible taxpayers}}{\text{sum of QRTMEs of all members that are eligible taxpayers.}}$$

(ii) *Stand-alone entity credit.* The term *stand-alone entity credit* means the RTMC (if any) that would be allowable to a member of a controlled group if the credit were computed as if section 45G(e)(2) did not apply, except that the member must apply the rules provided in paragraphs (f)(5) (relating to consolidated groups) and (f)(8) (relating to intra-group transactions) of this section.

(5) *Special rules for consolidated groups*—(i) *In general.* For purposes of applying paragraph (f)(4) of this section, a consolidated group whose members are members of a controlled group is treated as a single member of the controlled group and a single stand-alone entity credit is computed for the consolidated group.

(ii) *Special rule for allocation of group credit among consolidated group members.* The portion of the group credit that is allocated to a consolidated group is allocated to the members of the consolidated group in accordance with the principles of paragraph (f)(4) of this section. However, for this purpose, the stand-alone entity credit of a member of a consolidated group is computed without regard to section 45G(e)(2).

(6) *Tax accounting periods used*—(i) *In general.* The credit allowable to a member of a controlled group is that member's share of the group credit computed as of the end of that member's taxable year. In computing the group credit for a group whose members have different taxable years, a member generally should treat the taxable year of another member that ends with or within the credit year of the computing member as the credit year of that other member. For example, Q, R, and S are members of a controlled group of corporations. Both Q and R are calendar year taxpayers. S files a return using a fiscal year ending June 30. For purposes of computing the group credit at the end of Q's and R's taxable year on December 31, S's fiscal year ending June 30, which ends within Q's and R's taxable year, is treated as S's credit year.

(ii) *Special rule when timing of QRTME is manipulated.* If the timing of QRTME by members using different tax accounting periods is manipulated to generate a credit in excess of the amount that would be allowable if all members of the group used the same tax accounting period, then the appropriate Internal Revenue Service official in the operating division that has examination jurisdiction of the return may require each member of the group to calculate the credit in the current taxable year and all future years as if all members of the group had the same taxable year and base period as the computing member.

(7) *Membership during taxable year in more than one group.* A trade or business may be a member of only one group for a taxable year. If, without application of this paragraph (f)(7), a business would be a member of more than one group at the end of its taxable year, the business shall be

treated as a member of the group in which it was included for its preceding taxable year. If the business was not included for its preceding taxable year in any group in which it could be included as of the end of its taxable year, the business shall designate in its timely filed (including extensions) federal income tax return for the taxable year the group in which it is being included. If the business does not so designate, then the appropriate Internal Revenue Service official in the operating division that has examination jurisdiction of the return will determine the group in which the business is to be included. If the Federal income tax return for a taxable year beginning after December 31, 2004, and ending before November 9, 2007, was filed before December 13, 2007, and the business wants to apply paragraph (g)(2) of this section but did not designate its group membership in that return, the business must designate its group membership for that year either—

(i) In its next filed original Federal income tax return; or

(ii) In its amended Federal income tax return that is filed pursuant to paragraph (g)(2) of this section, provided that amended Federal income tax return is filed by the business before its next filed original Federal income tax return.

(8) *Intra-group transactions*—(i) *In general*. Because all members of a group under common control are treated as a single taxpayer for purposes of determining the RTMC, transfers between members of the group are generally disregarded.

(ii) *Payment for QRTME*. Amounts paid or incurred by the owner (or lessor) of eligible railroad track to another member of the group for QRTME shall be taken into account as QRTME by the owner (or lessor) of the eligible railroad track for purposes of section 45G only to the extent of the lesser of—

(A) The amount paid or incurred to the other member; or

(B) The amount that would have been considered paid or incurred by the other member for the QRTME, if the QRTME was not reimbursed by the owner (or lessor) of the eligible railroad track.

(g) *Effective/applicability date*—(1) *In general*. Except as provided in paragraphs (g)(2) and (g)(3) of this section, this section applies to taxable years ending on or after September 7, 2006.

(2) *Taxable years ending before September 7, 2006*. A taxpayer may apply this section to taxable years beginning after December 31, 2004, and ending before September 7, 2006, provided that the taxpayer applies all provisions in this section to the taxable year.

(3) *Special rules for returns filed prior to November 9, 2007*. If a taxpayer's Federal income tax return for a taxable year beginning after December 31, 2004, and ending before November 9, 2007, was filed before December 13, 2007, and the taxpayer is not filing an amended Federal income tax return for that taxable year pursuant to paragraph (g)(2) of this section before the taxpayer's next filed original Federal income tax return, see paragraphs (d)(4)(iv) and (f)(7) of this section for the statements that must be attached to the taxpayer's next filed original Federal income tax return.

§1.45G–1T [Removed]

Par. 5. Section 1.45G–1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (b) is amended by removing the entry for "1.45G–1T" from the table.

Par. 8. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control no.
* * * * *	
1.45G–1	1545–2031
* * * * *	

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved November 2, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 9, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 13, 2007, 72 F.R. 63813)

Section 1001.—Determination of Amount and Recognition of Gain or Loss

26 CFR 1.1001–3: Modifications of debt instruments.

This revenue procedure describes the conditions under which changes to certain subprime mortgage loans will not cause the Internal Revenue Service to challenge the tax status of certain securitization vehicles holding the loans. See Rev. Proc. 2007-72, page 1257.

Section 3121.—Definitions

26 CFR 31.3121(a)(5)–2: Payments under or to an annuity contract described in section 403(b).

T.D. 9367

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

Payments Made by Reason of a Salary Reduction Agreement

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document promulgates a final regulation that defines the term *salary reduction agreement* for purposes of section 3121(a)(5)(D) of the Internal Revenue Code (Code). The final regulation provides guidance to employers (public educational institutions and section 501(c)(3) organizations) purchasing annuity contracts described in section 403(b) on behalf of their employees.

DATES: *Effective Date:* This regulation is effective November 15, 2007.

Applicability Date: This regulation applies to contributions to section 403(b) plans made on or after November 15, 2007.

FOR FURTHER INFORMATION CONTACT: Neil D. Shepherd, (202) 622–6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This final regulation amends the Employment Tax Regulations (26 CFR part 31) by providing guidance relating to section 3121(a)(5)(D). The Federal Insurance Contributions Act (FICA) imposes taxes on employees and employers equal to a percentage of the wages received with respect to employment. Section 3121(a) defines wages for FICA tax purposes as all remuneration for employment unless otherwise excepted. Section 3121(a)(5)(D), added by the Social Security Amendments of 1983 (Public Law 98–21 (97 Stat. 65)), generally excepts from wages payments made by an employer for the purchase of an annuity contract described in section 403(b). However section 3121(a)(5)(D) expressly excludes from the exception payments made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise). Thus, payments made under a salary reduction agreement to purchase a section 403(b) annuity contract are included in wages for FICA purposes. A temporary and proposed regulation (T.D. 9159, 2004–2 C.B. 895) defining the term "salary reduction agreement" for purposes of section 3121(a)(5)(D) was published in the **Federal Register** (69 FR 67054) on November 16, 2004.

For income tax purposes, contributions made by an employer to a section 403(b) contract, including contributions made pursuant to a cash or deferred election or other salary reduction agreement, are generally excluded from income. §403(b); see also section 1450(a) of the Small Business Job Protection Act of 1996 (Public Law 104–188 (110 Stat. 1755)). Conversely, for FICA tax purposes, contributions made by an employer to a section 403(b) contract pursuant to a cash or deferred election or other salary reduction agreement are included in wages. §3121(a)(5)(D); see also S. Rep. No. 98–23, at 40–41, 98th Cong., 1st Sess. (1983).

Summary of Comments and Explanation of Provisions

This regulation finalizes the temporary and proposed regulation without change. The final regulation provides that the term "salary reduction agreement" includes (1) a plan or arrangement whereby a payment will be made if the employee elects to reduce his or her compensation pursuant to a cash or deferred election as defined at §1.401(k)–1(a)(3) of the Income Tax Regulations, (2) a plan or arrangement whereby a payment will be made if the employee elects to reduce his or her compensation pursuant to a one-time irrevocable election made at or before the time of initial eligibility to participate in such plan or arrangement (or pursuant to a similar arrangement involving a one-time irrevocable election), and (3) a plan or arrangement whereby a payment will be made if the employee agrees as a condition of employment (whether such condition is set by statute, contract, or otherwise) to make a contribution that reduces the employee's compensation.

Comments were submitted with respect to the definition of the term "salary reduction agreement" for purposes of section 3121(a)(5)(D) and with respect to the applicability date of the temporary and proposed regulation.

Salary Reduction Agreement

Commentators asserted that Congress intended the term "salary reduction agreement" in section 3121(a)(5)(D) to apply only to voluntary reductions in salary and not to salary reductions required as a condition of employment. In support of this view, commentators cited the legislative history underlying section 3121(a)(5)(D), particularly the following language from the Senate Report:

> The bill also provides that any amounts paid by an employer to a tax-sheltered annuity by reason of a salary reduction agreement between the employer and the employee would be includible in the employee's social security wage base. The committee intended that the provision would merely codify the holding of Revenue Ruling 65–208, 1965–2 Cum. Bull. 383, without any implication with respect to the issue of whether a particular amount paid by an employer to a tax-sheltered annuity is, in fact, made by reason of a "salary reduction agreement."

S. Rep. No. 98–23, at 40–41, 98th Cong., 1st Sess. (1983).

Commentators maintained that Revenue Ruling 65–208 distinguishes between voluntary and mandatory salary reduction contributions and that the legislative history reflects Congress' intent to treat only voluntary salary reduction contributions as having been made by reason of a salary reduction agreement. While the Senate Report indicates a Congressional intent to "codify the holding of Revenue Ruling 65–208," the revenue ruling does not address any distinction between voluntary and mandatory reductions in salary. The critical distinction drawn in Revenue Ruling 65–208 is between situations "where an organization uses its own funds for the purchase of an annuity contract" (a supplemental contribution)

and situations "where the employee takes a voluntary reduction in salary to provide the necessary funds" (a salary reduction contribution). At the time Revenue Ruling 65–208 was issued the statutory standard under section 3121(a)(2) for determining whether to include contributions to section 403(b) annuity contracts in wages for FICA purposes was whether the contributions had been paid by the employer or by the employee. Thus, in determining whether the employer or the employee has paid the contribution, the revenue ruling distinguishes between supplemental contributions funded by the employer and salary reduction contributions funded by the employee. Whether a salary reduction contribution was voluntary or mandatory is irrelevant in establishing that the employee funded the contribution through a reduction in salary.

Several courts have discussed Revenue Ruling 65–208 and confirmed that it addresses the distinction between salary supplements and salary reductions. See *Temple University v. United States*, 769 F.2d 126, 130 (3d Cir. 1985), discussing the distinction drawn by Revenue Ruling 65–208 between supplemental contributions and salary reduction contributions, and *Canisius College v. United States*, 799 F.2d 18, 20–21 (2d Cir. 1986), distinguishing between "salary supplement plans" and "salary reduction plans." See also *University of Chicago v. United States*, No. 06 C 3452, 2007 U.S. Dist. LEXIS 61632, at *8 (N.D. Ill. Aug. 21, 2007) concluding that "the distinction that was being drawn in [Revenue Ruling 65–208] was between annuity purchase funds that come from employee contributions and those that come from employer contributions." The Treasury Department and the Internal Revenue Service (IRS) continue to believe that it is consistent with the legislative history of section 3121(a)(5)(D) and with the codification of Revenue Ruling 65–208 to treat both voluntary salary reductions and salary reductions to which the employee agrees as a condition of employment as payments made pursuant to a salary reduction agreement.

Commentators suggested that the term "salary reduction agreement" for purposes of section 3121(a)(5)(D) should mean an elective deferral within the meaning of section 402(g)(3)(C), which defines the term *elective deferral* for purposes of the section 402(g)(3) limit on the exclusion of elective deferrals from gross income. In their view, because salary reduction contributions made pursuant to a one-time irrevocable election or as a condition of employment are not elective deferrals under section 402(g)(3)(C) and its accompanying regulations, such contributions are not made pursuant to a salary reduction agreement and, consequently, are excluded from wages under section 3121(a)(5)(D).

Section 402(g)(3)(C) provides that the term "elective deferral" includes "any employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement (within the meaning of section 3121(a)(5)(D))." However, when enacting section 402(g)(3), Congress made the following statement about the relationship among mandatory salary reduction contributions, elective deferrals, and salary reduction agreements: "if an employee is required to contribute a fixed percentage of compensation to a tax-sheltered annuity as a condition of employment, the contributions are not treated as elective deferrals." H.R. Rep. No. 99–841 at II–405 (1986). Similarly, in 1988 Congress added the flush language of 402(g)(3) providing that a one-time irrevocable election will not be treated as an elective deferral. Congress added the flush language to clarify that the term "elective deferral" excludes contributions "made pursuant to a one-time election to participate in the tax-sheltered annuity even though such contribution would be considered made under a salary reduction agreement under section 3121(a)(5)(D)." S. Rep. No. 100–445, at 151, 100th Cong., 2d Sess. (1988). Congress explained the clarification to section 402(g)(3) as follows:

> The bill conforms the statutory language to the legislative history by providing that contributions to a tax-sheltered annuity are not considered elective deferrals if the contributions are made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the annuity or are made pursuant to a similar arrangement specified in regulations. The bill does not change the definition of salary reduction agreement for purpose of section 3121(a)(5)(D).

Sen. Rep. 100–445, 100th Cong., 2d Sess. (1988) 151.

Thus, as reflected in both the statutory language of section 402(g) and in its legislative history, Congress intended the definition of salary reduction agreement for purposes of section 3121(a)(5)(D) to be distinct from the definition of elective deferral for purposes of section 402(g)(3)(C).

Furthermore, Congress intended that the term *wages* would have different meanings for income tax withholding and FICA tax purposes. The broader scope of the term for FICA tax purposes is consistent with the general policy underlying the FICA. See S. Rep. No. 98–23, at 39, 98th Cong., 1st Sess. (1983) relating to the Social Security Amendments of 1983 (Public Law 98–21 (97 Stat. 65)). Moreover, the legislative history to section 3121(a)(5)(D) cited in this preamble describes Congress's intent to codify the holding in Revenue Ruling 65–208 (see §601.601(d)(2)(ii)(*b*)), which provides that certain amounts included in income and amounts included in wages with respect to contributions used to purchase a 403(b) annuity contract are not the same. Based on the statutory language and the legislative history of section 3121(a)(5)(D) and related provisions, including section 3121(v)(1)(B) as discussed in this preamble, the Treasury Department and the IRS continue to believe that the term "salary reduction agreement" in section 3121(a)(5)(D) includes salary reduction contributions made pursuant to a one-time irrevocable election or as a condition of employment.

The term "salary reduction agreement" is used not only in section 3121(a)(5)(D) but also in another subsection of section 3121, specifically section 3121(v)(1)(B), which provides that wages include "any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise)." Commentators contended that the term "salary reduction agreement" should be interpreted differently for purposes of sections 3121(a)(5)(D) and 3121(v)(1)(B) because section 3121(v)(1)(B) applies only to salary reduction contributions made under

a section 414(h) pick-up plan established by a State or local government employer. By definition, the salary reductions that fund these employer contributions are mandatory whereas contributions to section 403(b) annuity plans may be mandatory or voluntary. While it is correct that salary reductions in connection with section 414(h) pick-up plans are mandatory, we see no evidence in the statute or legislative history that Congress intended to interpret the same language differently or to treat similarly situated employees differently for FICA purposes. Both section 3121(a)(5)(D) and section 3121(v)(1)(B) include salary reduction contributions in wages for FICA tax purposes. Neither the statute nor the legislative history gives a basis for concluding that mandatory salary reductions made in connection with a section 414(h) pick-up plan should be included in wages for FICA purposes while mandatory salary reductions made in connection with a section 403(b) annuity plan should be excluded from wages. Thus, the Treasury Department and the IRS continue to believe that it is appropriate to give a consistent interpretation to identical language in two subsections of the same statutory section enacted only one year apart.

Similarly, as discussed in the preamble to the temporary and proposed regulation, the Tenth Circuit's decision in *Public Employees' Retirement Board v. Shalala*, 153 F.3d 1160 (10th Cir. 1998) supports the view that a mandatory salary reduction contribution nonetheless requires the employee's agreement. In *Public Employees' Retirement Board* the Court of Appeals held that the term "salary reduction agreement" includes mandatory salary reduction contributions made as a condition of employment. As the Court said, "[A]n employee's decision to go to work or continue to work . . . constitutes conduct manifesting assent to a salary reduction." 153 F.3d at 1166. The employment relationship itself is a voluntary relationship, and the employee manifests his or her agreement with the terms and conditions of the employment relationship by accepting employment. See *University of Chicago v. United States*, No. 06 C 3452, 2007 U.S. Dist. LEXIS 61632, at *7 (N.D. Ill. Aug. 21, 2007) citing *Public Employees' Retirement Board* for the proposition that "a salary reduction agreed to as a condition of employment constitutes a salary reduction agreement because 'the employee has "agreed" to the salary reduction by continuing employment.'" The temporary and proposed regulations, and now the final regulations, read the term "agreement" for purposes of section 3121(a)(5)(D) as the Tenth Circuit read it for purposes of section 3121(v)(1)(B), as both an agreement to accept employment subject to a mandatory salary reduction and an agreement to a specified salary reduction.

Accordingly, the final regulation adopts the definition of salary reduction agreement as proposed.

Applicability Date

Commentators asked the IRS to confirm that the definition of salary reduction agreement provided in the temporary and proposed regulation would apply prospectively only and, therefore, would not affect contributions to a section 403(b) plan made prior to November 16, 2004, the date the temporary and proposed regulation went into effect. As explicitly set forth in §31.3121(a)(5)–2T the temporary and proposed regulation was applicable to contributions to section 403(b) annuity plans made on or after November 16, 2004. Therefore, the Internal Revenue Service will not apply the temporary and proposed regulation to contributions made to any section 403(b) plan prior to November 16, 2004, for purposes of determining whether such contributions were subject to FICA tax. The final regulation will apply only to contributions made to any section 403(b) plan on or after November 15, 2007.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) do not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Drafting Information

The principal author of this regulation is Neil D. Shepherd, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in its development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 31.3121(a)(5)–2 is added to read as follows:

§31.3121(a)(5)–2 Payments under or to an annuity contract described in section 403(b).

(a) *Salary reduction agreement defined.* For purposes of section 3121(a)(5)(D), the term *salary reduction agreement* means a plan or arrangement (whether evidenced by a written instrument or otherwise) whereby payment will be made by an employer, on behalf of an employee or his or her beneficiary, under or to an annuity contract described in section 403(b)—

(1) If the employee elects to reduce his or her compensation pursuant to a cash or deferred election as defined at §1.401(k)–1(a)(3) of this chapter;

(2) If the employee elects to reduce his or her compensation pursuant to a one-time irrevocable election made at or before the time of initial eligibility to participate in such plan or arrangement (or pursuant to a similar arrangement involving a one-time irrevocable election); or

(3) If the employee agrees as a condition of employment (whether such condition is set by statute, contract, or otherwise) to make a contribution that reduces his or her compensation.

(b) *Effective/applicability date.* This section is applicable on November 15, 2007.

§31.3121(a)(5)–2T [Removed]

Par. 3. Section 31.3121(a)(5)–2T is removed.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved November 13, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 14, 2007, 1:17 p.m., and published in the issue of the Federal Register for November 19, 2007, 72 F.R. 64939)

Section 6033.—Returns by Exempt Organizations

26 CFR 1.6033–6T: Notification requirement for entities not required to file an annual information return under section 6033(a)(1) (taxable years beginning after December 31, 2006)

T.D. 9366

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Notification Requirement for Tax-Exempt Entities Not Currently Required to File

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations describing the time and manner in which certain tax-exempt organizations not currently required to file an annual information return under section 6033(a)(1) are required to submit an annual electronic notice including certain information required by section 6033(i)(1)(A) through (F). The text of the temporary regulations also serves as the text of the proposed regulations (REG–104942–07) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on November 15, 2007.

Applicability Date: These regulations are applicable to taxable years beginning after December 31, 2006.

FOR FURTHER INFORMATION CONTACT: Monice Rosenbaum at (202) 622–6070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 6033(i)(1) relating to the notification requirement for entities not currently required to file an annual information return under section 6033(a)(1). Section 6033(i)(1) was added by section 1223(a) of the Pension Protection Act of 2006, Public Law 109–208 (120 Stat. 1090 (2006)) (PPA 2006), effective for annual periods beginning after 2006. Section 6033(i)(1) requires the Treasury Secretary to promulgate regulations that describe the time and manner in which certain tax-exempt organizations not currently required to file an annual information return are to submit an annual electronic notice including information set forth in section 6033(i)(1)(A) through (F). Section 1223 of the PPA 2006 also contains new rules for termination, loss of exempt status, and reinstatement. These new rules do not require regulations for implementation and are therefore not addressed in this temporary regulation but are discussed in this preamble. Substantive and administrative rules related to termination, loss of exempt status, and reinstatement will be considered in separate guidance and other publications.

Prior to the PPA 2006, either by operation of law or through discretionary exceptions, certain organizations were not required to file an information return (for example, Form 990, *"Return of Organization Exempt From Income Tax")*. Section 6033(a)(3)(A)(ii) provided a mandatory exception from filing by certain organizations (other than private foundations) described in section 6033(a)(3)(C), whose annual gross receipts were normally not more than $5,000. Section 6033(a)(3)(B) provided a discretionary exception under which the Secretary relieved certain other organizations from filing. Exercising this discretionary authority, the IRS published Announcement 82–88, 1982–25 I.R.B. 23 (June 21, 1982), which provided an exception for organizations whose annual gross receipts were not normally in excess of $25,000 from filing Form 990 for tax years ending on or after December 31, 1982. The new electronic notice provision of section 6033(i)(1) applies to organizations whose gross receipts are low enough that they are not required to file information returns under sections (a)(3)(A)(ii) or (a)(3)(B). The substance of this electronic notice is discussed below in this preamble. See §601.601(d)(2)(ii)(*b*).

Section 6033(i)(2) provides that organizations required to submit annual electronic notification are also required to provide notice of termination upon the termination of the existence of the organization. The time and manner of the notice of termination is not specified in the statute.

Section 6033(j), added by section 1223(b) of the PPA 2006, provides that if an organization required to file an annual information return under section 6033(a)(1) or submit an electronic notice under section 6033(i) fails to provide the required return or notice for three consecutive years, the organization's tax-exempt status is revoked. The revocation is effective from the date the Secretary determines was the last day the organization could have timely filed the third required information return or submitted the notice. Any organization whose tax-exempt status is revoked under section 6033(j)(1) must apply in order to obtain reinstatement of that status regardless of whether such organization was originally required to make an application for tax-exempt status. If, upon application for reinstatement of tax-exempt status, an organization can show to the satisfaction of the Secretary evidence of reasonable cause for the failure to file the information return or submit the notice, the organization's tax-exempt status may, in the discretion of the Secretary, be reinstated retroactive to the date of revocation.

Section 7428(b), regarding limitations on declaratory judgments relating to status and classification of certain tax-exempt organizations, was amended by section 1223(c) of the PPA 2006 and provides that no action may be brought under section 7428 with respect to any revocation of tax-exempt status described in section 6033(j)(1), for failure to provide the required return under section 6033(a)(1)

or notice under section 6033(i) for three consecutive years.

Section 6652(c)(1)(E), added by section 1233(d) of the PPA 2006, provides that there is no monetary penalty for failure to submit any notice required under section 6033(i).

Explanation of Provisions

Annual Electronic Notice Requirements and Other General Requirements Related to Maintaining Tax-Exempt Status

Section 6033(i)(1) provides that the annual notification, in electronic form, shall set forth: (A) the legal name of the organization, (B) any name under which the organization operates or does business, (C) the organization's mailing address and Internet Web site address (if any), (D) the organization's taxpayer identification number, (E) the name and address of a principal officer, and (F) evidence of the continuing basis for the organization's exemption from the filing requirements under section 6033(a)(1). The temporary regulations also provide that additional information necessary to process the notification may be required. For example, an organization will be required to state the tax period for which it is submitting the electronic notification.

The mailing address required by section 6033(i)(1)(C) and submitted in the annual electronic notification shall be the organization's last known address as provided by §301.6212–2(a) of the Regulations on Procedure and Administration. This last known address may be updated as provided under §301.6212–2 or by clear and concise notification as described in Rev. Proc. 2001–18, 2001–1 C.B. 708. The IRS will use this last known address as the organization's address of record and will direct all mailings to this address. See §601.601(d)(2)(ii)(*b*).

By submitting the annual electronic notification described in this paragraph, an organization acknowledges that it is not required to file a return under section 6033(a) because its gross receipts are not normally in excess of $25,000. In order to make this determination, the organization must keep records that enable it to calculate its gross receipts. All organizations are required to maintain records under section 6001. These records will provide evidence of the continuing basis for the organization's exemption from the filing requirements under section 6033(a)(1).

The temporary regulations restate that an organization, even though relieved from filing a return under section 6033(a), is still required under §1.6033–2(i) and (j) to inform the IRS in writing of any changes in the organization's character, operation, or purpose; provide additional information; and file other returns of information and unrelated business tax returns. Organizations are also reminded that if the organization is required to file an unrelated business tax return, Form 990–T, *"Exempt Organization Business Income Tax Return,"* the filing of the Form 990–T does not relieve the organization from the requirement of submitting the annual electronic notification under section 6033(i).

The statute requires that the annual notification be submitted electronically. There is no provision in the temporary regulations for any paper notification. However, if an organization that is required to submit an annual electronic notification files a complete Form 990 or Form 990EZ, *"Short Form Return of Organization Exempt From Income Tax,"* the annual notification requirement of section 6033(i) shall be deemed satisfied. The annual notification requirement is not satisfied if the Form 990 or Form 990–EZ contains only those items of information that would have been required by submitting the notification in electronic form.

The notification shall be submitted on or before the 15th day of the fifth calendar month following the close of the period for which the notification is required to be submitted. Thus, an organization with an accounting period ending December 31, 2007, is required to submit the annual notification by May 15, 2008.

Annual Electronic Notification Is Not a Return

The electronic notification is not a return because it does not contain sufficient data to calculate tax liability or determine tax-exempt status. Moreover, the electronic notification does not purport to be a return. The electronic notification simply identifies an organization and indicates the basis for it not having to file an information return under section 6033(a)(1). Because the electronic notification is not a tax or information return, submission of the notification does not trigger the period of limitations for assessment under section 6501(g)(2). However, the filing of a complete Form 990 or Form 990–EZ, as noted in this preamble, will start the period of limitations for assessment under section 6501(g)(2). Furthermore, there is no monetary penalty for failure to file under section 6033(i). To further distinguish the electronic notification from a tax or information return, the temporary regulations provide that the electronic notification is submitted to the IRS, rather than filed or furnished, the terms used in connection with tax and information returns.

The notifications required by section 6033(i) are subject to public disclosure and inspection. See section 6104 (generally applicable to Form 990 information returns). Further, this provision does not affect any other obligations an organization may have to file other required information and or tax returns, or penalties for failure to file such returns.

Form 990–N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990–EZ

Form 990–N, *"Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required To File Form 990 or 990–EZ,"* has been developed to satisfy the requirements of section 6033(i)(1). The IRS plans to deliver a simple, Internet based process for submitting the e-Postcard, Form 990–N. It is anticipated that organizations that do not have access to a computer can use their local public library to file the e-Postcard. Because the system will be Internet based, organizations should not need to purchase software to file the e-Postcard. The temporary regulations provide that the annual electronic notification shall be submitted in accordance with instructions and publications, including those provided at the IRS Web site for exempt organizations.

Organizations Required to File Returns or Submit Electronic Notice

In general, every organization exempt from taxation under section 501(a) that is not required to file a return described in §1.6033–2(a)(2), other than an organization described in section 401(a) (qualified

pension, profit-sharing, and stock bonus plans) or section 501(d) (religious and apostolic organizations), is required to submit an annual electronic notice under section 6033(i). However, a organization that is required to file or files an annual information return under section 6033(a)(1) should not submit an annual electronic notification under section 6033(i). This includes any organization included in a group return as provided in §1.6033–2 for that year; all private foundations required to file Form 990–PF, *"Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation"*; section 509(a)(3) supporting organizations required to file Form 990 or Form 990–EZ; a section 501(c)(21) black lung trust required to file Form 990–BL, *"Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Persons"*; and any organization that is required to file or files an annual information return under section 6033(a)(1) on any other form prescribed by the IRS for that purpose.

Neither annual information returns under section 6033(a)(1) nor annual electronic notices under section 6033(i) are required to be filed or submitted by an organization exempt from taxation under section 501(a) that is a church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church (as defined in §1.6033–2(h)); an exclusively religious activity of any religious order; a mission society sponsored by or affiliated with one or more churches or church denominations, more than half of the activities of which society are conducted in, or directed at persons in, foreign countries; an educational organization (below college level) that is described in section 170(b)(1)(A)(ii), that has a program of a general academic nature, and that is affiliated (within the meaning of §1.6033–2(h)(2)) with a church or operated by a religious order; a State institution, the income of which is excluded from gross income under section 115(a); an organization described in section 501(c)(1); or an organization that is a governmental unit or an affiliate of a governmental unit exempt from Federal income tax under section 501(a) as described in Rev. Proc. 95–48, 1995–2 C.B. 418. See §601.601(d)(2)(ii)(*b*).

If an organization exempt from taxation under section 501(a) is not exempted in either of the two preceding paragraphs, the organization must submit an annual electronic notice. Thus, a black lung trust that normally has gross receipts of $25,000 or less is not required to file Form 990–BL but is required to submit an electronic notification. A section 509(a)(3) supporting organization of a religious organization that normally has gross receipts of $5,000 or less is not required to file Form 990 or Form 990–EZ but is required to submit an electronic notification.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Monice Rosenbaum, of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

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Amendments to the Regulations.

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6033–6 also issued under 26 U.S.C. 6033(i)(1). * * *

Par. 2 Section 1.6033–6T is added to read as follows:

§1.6033–6T Notification requirement for entities not required to file an annual information return under section 6033(a)(1) (taxable years beginning after December 31, 2006)—

(a) *In general.* Except as otherwise provided in this paragraph, every organization exempt from taxation under section 501(a) that is not required to file a return described in §1.6033–2(a)(2), other than an organization described in section 401(a) or 501(d), shall submit annually, in electronic form, a notification setting forth the items described in paragraph (b) of this section and such other information as may be prescribed in the instructions and publications issued with respect to the notification.

(b) *Organizations not required to submit annual notification.* (1) An organization exempt from taxation under section 501(a) that is required to file or files an annual information return under section 6033(a)(1) shall not submit an annual notification under section 6033(i). This includes the following types of organizations:

(i) Any organization included in a group return for that year under §1.6033–2(d).

(ii) All private foundations required to file under §1.6033–2(a)(2)(i) Form 990–PF, *"Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation."*

(iii) Section 509(a)(3) supporting organizations required to file under §1.6033–2(a)(2)(i) Form 990, *"Return of Organization Exempt From Income Tax,"* or Form 990–EZ, *"Short Form Return of Organization Exempt From Income Tax."*

(iv) A section 501(c)(21) black lung trust required to file under §1.6033–2(a)(2)(i) Form 990–BL.

(v) Any organization that is required to file or files an annual information return under section 6033(a)(1) on any other form prescribed by the Internal Revenue Service for that purpose.

(2) An organization exempt from taxation under section 501(a) that is not required to file a return under section 6033(a)(1) is also not required to sub-

mit an annual notification under section 6033(i). This includes the following types of organizations:

(i) A church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church (as defined in §1.6033–2(h)).

(ii) An exclusively religious activity of any religious order.

(iii) A mission society sponsored by or affiliated with one or more churches or church denominations, more than one-half of the activities of which society are conducted in, or directed at persons in, foreign countries.

(iv) An educational organization (below college level) described in section 170(b)(1)(A)(ii), that has a program of a general academic nature, and that is affiliated (within the meaning of §1.6033–2(h)(2)) with a church or operated by a religious order.

(v) A State institution, the income of which is excluded from gross income under section 115(a);

(vi) An organization described in section 501(c)(1); or

(vii) An organization that is a governmental unit or an affiliate of a governmental unit exempt from Federal income tax under section 501(a).

(3) If an organization exempt from taxation under section 501(a) is not described in paragraph (b)(1) or (2) of this section, the organization must submit an annual notification. Thus, a black lung trust that normally has gross receipts of $25,000 or less is not required to file Form 990–BL but is required to submit electronic notification. A section 509(a)(3) supporting organization of a religious organization that normally has gross receipts of $5,000 or less is not required to file Form 990 or Form 990–EZ but is required to submit electronic notification.

(c) *Additional notification requirements*—(1) *In general.* Any organization described in paragraph (a)(1) of this section shall submit an annual notification described in section 6033(i)(1). The annual notification shall—

(i) Be in electronic form; and

(ii) Set forth—

(A) The legal name of the organization;

(B) Any name under which the organization operates or does business;

(C) The organization's mailing address and Internet Web site address (if any);

(D) The organization's taxpayer identification number;

(E) The name and address of a principal officer;

(F) Evidence of the continuing basis for the organization's exemption from the filing requirements under section 6033(a)(1); and

(G) Additional information necessary to process the notification.

(2) The mailing address required by section 6033(i)(1)(C) and submitted in the annual notification shall be the organization's last known address as provided by §301.6212–2(a) of this chapter. This last known address may be updated as provided under §301.6212–2 of this chapter, or by clear and concise notification. The Internal Revenue Service will use this last known address as the organization's address of record and will direct all mailings to this address.

(3) By submitting the annual notification described in this paragraph (c)(1), an organization acknowledges that it is not required to file a return under section 6033(a) because its annual gross receipts are not normally in excess of $25,000. In order to make this determination, the organization must keep records that enable it to calculate its gross receipts. All organizations are required to maintain records under section 6001. These records will provide evidence of the continuing basis for the organization's exemption from the filing requirements under section 6033(a)(1).

(4) If an organization that is required to submit an annual electronic notification files a complete Form 990 or Form 990–EZ the annual notification requirement shall be deemed satisfied. The annual notification requirement is not satisfied if the Form 990 or Form 990–EZ contains only those items of information that would have been required by submitting the notification in electronic form. Also, the filing of a complete Form 990 or Form 990–EZ, rather than the submission of an annual electronic notification, is the filing of a return that starts the period of limitations for assessment under section 6501(g)(2).

(d) *No effect on other filing requirements.* An organization that is relieved from filing an information return under section 6033(a) is still subject to the requirements of §1.6033–2(i) and (j), concerning notice regarding changes in character, operations, or purpose; providing additional information; duty to file other returns of information; and duty to file unrelated business tax returns. If an organization is required to file an unrelated business tax return, Form 990–T, *"Exempt Organization Business Income Tax Return,"* the filing of that return does not relieve the organization from the requirement of submitting notification under section 6033(i).

(e) *Accounting period for submitting electronic notification.* An annual notification required by this section shall be on the basis of the established annual accounting period of the organization. If the organization has no established accounting period, annual notification shall be on the basis of the calendar year.

(f) *Time and place for submitting electronic notification.* The annual notification required by this section shall be submitted on or before the 15th day of the fifth calendar month following the close of the period for which the notification is required to be submitted. Thus, an organization with an accounting period ending December 31, 2007, is required to submit annual notification by May 15, 2008. The notification shall be submitted in accordance with instructions and publications, including those provided at the Internal Revenue Service Web site for exempt organizations.

(g) *Effective/applicability date.* These regulations are applicable to annual periods beginning after 2006.

(h) *Expiration date.* These regulations expire February 12, 2010.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved November 6, 2007.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 14, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 15, 2007, 72 F.R. 64147)

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rates of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 2008, will be 7 percent for overpayments (6 percent in the case of a corporation), 7 percent for underpayments, and 9 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 4.5 percent.

Rev. Rul. 2007–68

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of October 2007 is 4 percent. Accordingly, an overpayment rate of 7 percent (6 percent in the case of a corporation) and an underpayment rate of 7 percent are established for the calendar quarter beginning January 1, 2008. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2008, is 4.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2008, is 9 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 4.5 percent, 6 percent, 7 percent, and 9 percent are published in Tables 14, 17, 19, and 23 of Rev. Proc. 95–17, 1995–1 C.B. 556, 568, 571, 573, and 577.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Wendy Kribell of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Kribell at (202) 622–4570 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 — PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575

TABLE OF INTEREST RATES FROM JAN. 1, 1987 — Dec. 31, 1998 – Continued						
	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES FROM JANUARY 1, 1999 — PRESENT NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS			
	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	7%	19	573

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PG
Apr. 1, 2006—Jun. 30, 2006	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	8%	21	575
Apr. 1, 2007- Jun. 30, 2007	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	8%	21	575
Jan. 1, 2008—Mar. 31, 2008	7%	67	621

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	4%	13	567	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	5%	15	569	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	5%	15	569	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	6%	17	571	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	6%	17	571	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	6%	17	571	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	7%	19	573	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	7%	19	573	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	7%	19	573	8%	21	575
Apr. 1, 2007- Jun. 30, 2007	7%	19	573	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	7%	19	573	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 — PRESENT – Continued

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 2008—Mar. 31, 2008	6%	65	619	7%	67	621

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621
Jan. 1, 2005—Mar. 31, 2005	7%	19	573
Apr. 1, 2005—Jun. 30, 2005	8%	21	575
Jul. 1, 2005—Sep. 30, 2005	8%	21	575
Oct. 1, 2005—Dec. 31, 2005	9%	23	577
Jan. 1, 2006—Mar. 31, 2006	9%	23	577
Apr. 1, 2006—Jun. 30, 2006	9%	23	577
Jul. 1, 2006—Sep. 30, 2006	10%	25	579
Oct. 1, 2006—Dec. 31, 2006	10%	25	579
Jan. 1, 2007—Mar. 31, 2007	10%	25	579
Apr. 1, 2007- Jun. 30, 2007	10%	25	579
Jul. 1, 2007—Sep. 30, 2007	10%	25	579
Oct. 1, 2007—Dec. 31, 2007	10%	25	579
Jan. 1, 2008—Mar. 31, 2008	9%	71	625

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618

TABLE OF INTEREST RATES FOR CORPORATE OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 — PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005—Mar. 31, 2005	2.5%	10	564
Apr. 1, 2005—Jun. 30, 2005	3.5%	12	566
Jul. 1, 2005—Sep. 30, 2005	3.5%	12	566
Oct. 1, 2005—Dec. 31, 2005	4.5%	14	568
Jan. 1, 2006—Mar. 31, 2006	4.5%	14	568
Apr. 1, 2006—Jun. 30, 2006	4.5%	14	568
Jul. 1, 2006—Sep. 30, 2006	5.5%	16	570
Oct. 1, 2006—Dec. 31, 2006	5.5%	16	570
Jan. 1, 2007—Mar. 31, 2007	5.5%	16	570
Apr. 1, 2007- Jun. 30, 2007	5.5%	16	570
Jul. 1, 2007—Sep. 30, 2007	5.5%	16	570
Oct. 1, 2007—Dec. 31, 2007	5.5%	16	570
Jan. 1, 2008—Mar. 31, 2008	4.5%	62	616

Section 7701.—Definitions

26 CFR 301.7701–4: Trusts.

This revenue procedure describes the conditions under which changes to certain subprime mortgage loans will not cause the Internal Revenue Service to challenge the tax status of certain securitization vehicles holding the loans. See Rev. Proc. 2007-72, page 1257.

Part III. Administrative, Procedural, and Miscellaneous

Modification of Q&A–23 of Notice 2007–7

Notice 2007–99

I. Purpose

This notice modifies Q&A–23 of Notice 2007–7, 2007–5 I.R.B. 395. Notice 2007–7, Q&A–23, states that the exclusion provided under § 402(l) of the Internal Revenue Code with respect to the payment of certain health insurance premiums by certain pension plans does not apply to premiums paid to an accident or health plan that is self-insured.

II. Background

Section 402(l) of the Internal Revenue Code, which was added by section 845(a) of Pension Protection Act of 2006, P.L. 109–280 ("PPA '06"), provides for an exclusion from gross income up to $3,000 annually for certain distributions paid from an eligible governmental plan that are used to pay qualified health insurance premiums of an eligible retired public safety officer or his or her spouse or dependents. The term "qualified health insurance premiums" is defined in § 402(l)(4)(D) as "premiums for coverage for the eligible retired public safety officer, his spouse, and dependents, by an accident or health *insurance* plan or qualified long-term care insurance contract (as defined in § 7702B(b))." (Emphasis added.) Section 402(l)(5)(A) further limits the exclusion to premiums that are paid "directly to the provider of the accident or health *insurance* plan or qualified long-term care insurance contract." (Emphasis added.) Section 402(l) applies to distributions in taxable years beginning after December 31, 2006.

Notice 2007–7, Q&A–23, provides that premiums paid to self-insured accident or health plans are not eligible for the § 402(l) exclusion from gross income because, in order to receive favorable tax treatment under § 402(l), the accident or health plan receiving the premium payments must be an accident or health insurance plan. Thus, the plan must be providing insurance issued by an insurance company regulated by a State (including a managed care organization that is treated as issuing insurance).

In general, §§ 104(a)(3) and 105(b) and (c) exclude from gross income certain amounts received through accident or health insurance. Under § 105(e)(1), amounts received under an accident or health plan for employees are treated as received through accident or health insurance for purposes of §§ 104 and 105. Section 1.105–5(a) of the Income Tax Regulations provides that an accident or health plan may be either insured or self-insured.

On August 2, 2007, S. 1974, the Pension Protection Technical Corrections Act of 2007, was introduced in the Senate and, on August 3, 2007, H.R. 3361, the Pension Protection Technical Corrections Act of 2007, was introduced in the House of Representatives. Both bills have identical provisions — § 9(i)(1)(B) and (C) of S. 1974 and H.R. 3361 — which would revise section 845(a) of PPA '06 by deleting the word "insurance" from the term "accident or health insurance plan," which occurs in both the definition of qualified health insurance premiums in § 402(l)(4)(D) of the Code and the direct payment requirement in § 402(l)(5)(A). Because of these pending technical corrections and special considerations involving eligible retired public safety officers, Notice 2007–7, Q&A–23, is being modified.

III. Modification of Notice 2007–7, Q&A–23

Notice 2007–7, Q&A–23, is modified as follows:

Q–23. Can the accident or health plan receiving the payments of qualified health insurance premiums be a self-insured plan?

A–23. Yes. An accident or health plan, which is defined under § 105(e), includes a self-insured plan. See § 1.105–5(a) of the Income Tax Regulations.

IV. EFFECT ON OTHER DOCUMENTS

Notice 2007–7 is modified.

DRAFTING INFORMATION

The principal author of this notice is Angelique Carrington of Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call the Employee Plans customer assistance service Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time at (877) 829–5500 (a toll-free number) or e-mail Ms. Carrington at *RetirementPlanQuestions@irs.gov.*

Transition Relief and Guidance on Corrections of Certain Failures of a Nonqualified Deferred Compensation Plan to Comply with § 409A(a) in Operation

Notice 2007–100

I. PURPOSE

This notice provides transition relief and guidance on the correction of certain failures of a nonqualified deferred compensation plan to comply with § 409A(a) in operation (an operational failure). This transition relief and additional guidance includes:

- Methods for correcting certain operational failures during the taxable year of the service provider in which the failure occurs to avoid income inclusion under § 409A(a).
- Transition relief limiting the amount includible in income under § 409A(a) for certain operational failures occurring in a service provider's taxable year beginning before January 1, 2010, that involve only limited amounts.
- An outline of, and request for comments on, a potential corrections program that would permit service recipients and service providers to limit the amounts required to be included in income under § 409A(a) due to certain operational failures.

II. CORRECTIONS OF CERTAIN OPERATIONAL FAILURES IN THE SAME TAXABLE YEAR AS THE FAILURE OCCURS

A. *General Requirements*

If an unintentional operational failure to comply with § 409A(a) occurs, but the operational failure is corrected in accordance with this § II, no amount is required to be included in income under § 409A(a) as a result of the failure. The relief provided by this § II applies only to unintentional operational failures, which means an unintentional failure to comply with plan provisions that satisfy the requirements of § 409A(a) and the guidance thereunder, or an unintentional failure to follow the requirements of § 409A(a) in practice, due to one or more inadvertent errors in the operation of the plan. This § II does not provide relief for plan terms and provisions that fail to meet the requirements of § 409A and the applicable guidance or for operational failures for which a correction is not described in this § II.[1] Relief is not available under this § II with respect to any intentional failure to comply with the terms of a plan or the requirements of § 409A in the operation of a plan. In addition, relief is not available under this § II with respect to any exercise of a stock right that otherwise would result in a failure to comply with § 409A. Relief otherwise available under this § II is conditioned upon the timely filing and providing of the information required by § IV of this notice.

The relief provided under this § II is not available unless, in addition to correcting the operational failure in accordance with this § II, the service recipient takes commercially reasonable steps to avoid a recurrence of the operational failure. If the same or a substantially similar operational failure has occurred previously, the relief is not available for any taxable year of the service provider beginning after December 31, 2008, unless the service recipient demonstrates that the service recipient had established practices and procedures reasonably designed to ensure that such an operational failure would not recur, had taken commercially reasonable steps to avoid a recurrence of the operational failure, and the operational failure occurred despite the diligent efforts of the service recipient.

Relief is not available under this § II with respect to any intentional failure to comply with the terms of a plan or the requirements of § 409A in the operation of a plan. The relief provided in this section also is not available with respect to an operational failure that is egregious, or where the failure is directly or indirectly related to participation in an abusive tax avoidance transaction (meaning for this purpose any listed transaction under § 1.6011–4(b)(2)).

In each instance, the taxpayer claiming the relief has the burden of demonstrating that the taxpayer was eligible for the relief and that the requirements of this section have been met. Any application of the relief provided in this section is subject to examination by the IRS.

B. *Failure to Defer Amount or Incorrect Payment Corrected in the Same Taxable Year*

This § II.B applies to amounts of nonqualified deferred compensation that, under the terms of the plan and any applicable deferral election, and § 409A and the applicable guidance, should not have been paid or made available to a service provider in a taxable year of the service provider, but were paid or made available in that year due to an unintentional operational failure with respect to the plan, other than a payment that fails to meet the requirements of § 409A(a)(2)(B)(i) and the applicable guidance thereunder (requirement to delay for six months payments to a specified employee upon separation from service). For rules relating to correction of certain payments made in violation of § 409A(a)(2)(B)(i) and the applicable guidance under that section, see § II.C of this notice.

An amount to which this § II.B applies is treated as having been timely deferred in accordance with the terms of the plan and any applicable deferral election (or as having continued to be deferred under the terms of the plan) if the service provider repays to the service recipient the amount that was erroneously paid or made available to the service provider on or before the last day of the service provider's taxable year in which such amount was erroneously paid or made available, and immediately after such repayment the service provider has a legally binding right under the plan to be paid the amount that would have been due if such amount had not been erroneously paid or made available to the service provider during such taxable year, at the same time and in the same form of payment that the amount would have been payable if such amount had not been erroneously paid or made available to the service provider during such taxable year.

In addition, if the total of all amounts to which this § II.B applies that are erroneously paid or made available under a plan (as defined for purposes of § 409A) in a service provider's taxable year exceeds the limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B) for the year in which the erroneous payment was made and the service provider is an insider (as defined in this § II.B) with respect to the service recipient, to qualify for the relief provided in this section, the service provider must also pay interest to the service recipient at the time the service provider repays the amount to the service recipient equal to the amount of the erroneous payment (E) multiplied by the short-term applicable Federal rate (AFR) under § 1274(d)(1) (r) multiplied by a fraction, the numerator of which is the number of days from the erroneous payment date to the repayment date (n_1) and the denominator of which is the number of days in such taxable year (n_2), or ($E \times r \times n_1/n_2$). For purposes of the preceding sentence, r is the short-term AFR, based on annual compounding, for the month in which the erroneous payment was paid or made available to the service provider. For purposes of counting days under this § II.B, the first day of the period is disregarded and the last day is taken into account. Where a repayment is made through a reduction of the service provider's other compensation, the repayment date occurs on each date the compensation otherwise would have been paid to the service provider, and if the amount withheld on a repayment date is less than the entire erroneous payment, the interest calculation in the preceding sen-

[1] Reliance on the transition relief provided in Notice 2007–86, 2007–46 I.R.B. 990, the preamble to the final regulations under § 409A, 72 Fed. Reg. 19234, Notice 2006–79, 2006–43 I.R.B. 763, the preamble to the proposed regulations under § 409A, 70 Fed. Reg. 57930, or Notice 2005–1, 2005–1 C.B. 274, for the years to which such transition relief applies, does not preclude a taxpayer from qualifying for the relief provided in this notice with respect to unintentional operational errors occurring in taxable years beginning before January 1, 2009.

tence is applied by substituting the unpaid balance immediately before the repayment for the amount of the erroneous payment.

For purposes of this notice, a service provider is an insider with respect to a service recipient if the service provider is a director or officer of the service recipient or is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security of the service recipient, determined in accordance with the rules of the Securities and Exchange Commission under § 16 of the Securities Exchange Act of 1934, as amended, 15 USC 78p, without regard to whether the service recipient has any class of equity securities registered under § 12 of such Act, 15 USC 78l. See 17 CFR § 240.16a–1(a) (beneficial owner) and (f) (officer). In the case of a service recipient that is not a corporation, such rules are applied by analogy.

The service provider may satisfy the requirement to repay the service recipient the amount erroneously paid to the service provider and interest (if applicable) by paying the service recipient the equivalent amount on or before the last day of such taxable year. Alternatively, in lieu of such repayment, the service recipient may reduce the service provider's compensation that otherwise would have been paid during such taxable year by an equivalent amount on or before the last day of such taxable year. In either case, an amount will not be treated as paid by the service provider if, in connection with such payment, the service recipient pays the service provider, or otherwise provides a benefit (including an obligation to pay an amount or provide a benefit in the future), intended as a substitute for all or part of the amount the service provider is required to repay the service recipient.

The amount erroneously paid to the service provider that is repaid by the service provider to the service recipient is not required to be included in income by the service provider, or reported as income to the service provider on a Form W–2 or Form 1099 by the service recipient. To the extent employment taxes have been withheld and paid with respect to such payment, appropriate adjustments should be made under the applicable rules under § 6413. To the extent that, in lieu of repayment, the service recipient reduces other compensation that would have been paid to the service provider, the other compensation that would have been paid to the service provider, but instead is used to repay the erroneous payment or to pay any required interest on the erroneous payment, is includible in income (and wages if the service provider is an employee); however, any employment taxes withheld and paid with respect to the original erroneous payment may be applied to satisfy the requirement to withhold and pay employment taxes on such compensation, in which case no adjustment to the employment taxes previously withheld and paid should be made.

For purposes of this § II.B, the service provider's account balance or other amount of deferred compensation under the plan may be adjusted for earnings (or losses) retroactive to the date the amount should have been credited to the service provider's account or otherwise deferred (or if the amount should have otherwise remained deferred compensation after the end of the service provider's taxable year, retroactive to the date the amount was paid or made available), provided that such adjustment must be made on or before the last day of such taxable year (or if it is impracticable to make the adjustment by the end of such taxable year, the service provider (in the case of earnings) and the service recipient (in the case of losses) must have a legally binding right to have such adjustment made on or before the last day of such taxable year).

The relief provided in this § II.B is not available with respect to any erroneous payment occurring during any taxable year of the service provider in which the service recipient experienced a substantial financial downturn or otherwise experienced financial or other issues that indicated a significant risk that the service recipient would not be able to pay the amount deferred when the payment became due.

In each of the following examples, it is assumed that Employer does not make any payment to Employee, or otherwise provide a benefit (including an obligation to pay an amount or provide a benefit in the future) to or on behalf of Employee, that is intended as a substitute for all or part of the amount that Employee pays to Employer (or the reduction in compensation otherwise payable to Employee), that Employee is an individual whose taxable year is the calendar year, that Employer did not experience a substantial financial downturn or otherwise experience financial or other issues that indicated a significant risk that the service recipient would not be able to pay the amount deferred when the payment became due, and that Employee and Employer each satisfy the other applicable requirements of this § II.

Example 1: Employee, who is not an insider with respect to Employer, makes a timely election to defer 50% of a bonus payable in 2007 pursuant to an account balance plan maintained by Employer. The bonus is $100,000. Due to an unintentional operational failure with respect to the plan, Employer defers only 10% of the bonus, or $10,000, and pays Employee the other $90,000 in 2007 (including the $40,000 that should have been deferred). The deferral is treated as made in accordance with the terms of the plan and the deferral election if, on or before December 31, 2007, the additional $40,000 is credited to Employee's account balance and Employee pays Employer $40,000. The $40,000 erroneously paid to Employee is not required to be included in income by Employee or reported by Employer on Form W–2. Alternatively, in lieu of the $40,000 repayment by Employee to Employer, compensation otherwise payable to Employee in 2007 (such as salary payments) may be reduced by $40,000, provided that the $40,000 reduction in Employee's compensation used to repay the amount (but not the $40,000 erroneous payment) is included in income by Employee and reported as wages by Employer on the 2007 Form W–2. Employer may also adjust Employee's account to reflect the earnings (or losses) that would have been allocated to Employee's account had the amount been timely deferred and credited to Employee's account balance, if such adjustment for earnings (or losses) is made on or before December 31, 2007. Alternatively, if it is impracticable to make the adjustment on or before December 31, 2007, such adjustment may be made later retroactively to December 31, 2007, provided that Employee and Employer each has a legally binding right on December 31, 2007 with respect to such adjustment. For example, if the original incorrect deferral would have been credited with 10% in deemed investment earnings, the deferral plus earnings would be $11,000. This amount must be increased by the $40,000 repaid by Employee and may also be increased by an additional $4,000 ($40,000 multiplied by 10%), to result in the $55,000 account balance that would have been reflected had the amount been properly deferred. If the original incorrect deferral would have been charged with 10% in deemed investment losses, the deferral less losses would be $9,000. This account balance must be increased by the $40,000, but may also be reduced by $4,000, for a net increase of $36,000, to result in the $45,000 account balance that would have been reflected had the amount been properly deferred.

Example 2: Pursuant to a nonqualified deferred compensation plan sponsored by Employer, Employee, who is an insider with respect to Employer, is scheduled to receive a $10,000 installment payment in 2007 that is not subject to the 6-month delay for payments to specified employees upon separation from service under § 409A(a)(2)(B)(i). Due to an unintentional operational failure with respect to the plan, Employer pays Employee $11,000. The

installment payment is treated as made in accordance with the terms of the plan and the deferral election if on or before December 31, 2007, the excess $1,000 payment is credited to Employee's account balance, and Employee pays Employer $1,000. The $1,000 is not required to be included in income by Employee or reported by Employer as wages on Form W–2. Alternatively, in lieu of the $1,000 payment by Employee to Employer, Employee's compensation otherwise payable in 2007 (such as salary payments) may be reduced by $1,000, provided that the $1,000 reduction in Employee's compensation used to repay the amount (but not the $1,000 erroneous payment) is included in income by Employee and reported by Employer as wages on the 2007 Form W–2. Because the excess $1,000 payment does not exceed the applicable limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B), Employee is not required to pay any interest to qualify for the relief. Employer may also adjust Employee's account to reflect the earnings (or losses) that would have been allocated to Employee's account had the amount been timely deferred and credited to Employee's account balance, if such adjustment for earnings (or losses) is made on or before December 31, 2007. Alternatively, if it is impracticable to make the adjustment on or before December 31, 2007, such adjustment may be made later retroactively to December 31, 2007, provided that on December 31, 2007, Employee and Employer each has a legally binding right with respect to such adjustment.

Example 3: Employee, who is an insider with respect to Employer, makes a timely election to defer 80% of a $100,000 bonus payable on July 1, 2009, pursuant to an account balance plan maintained by Employer. Due to an unintentional operational failure with respect to the plan, Employer defers only 10% of the bonus, or $10,000, and pays Employee the other $90,000 (including $70,000 that should have been deferred) on July 1, 2009. Assume for purposes of this example that the short-term AFR, based on annual compounding, for July 2009 is 4.0 percent. Employer notifies Employee of the error and Employee pays Employer $70,705.75 on October 1, 2009, consisting of the $70,000 erroneous payment plus interest equal to $705.75 ($70,000 x .04 x 92/365) (because the erroneous payment exceeds the limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B) for 2009 and Employee is an insider). The deferral is treated as made in accordance with the terms of the plan under this § II.B. The $70,000 is not required to be included in income by Employee or reported as wages by Employer on Form W–2. Alternatively, in lieu of the $70,705.75 payment by Employee to Employer, compensation otherwise payable to Employee in 2009 (such as salary payments) may be reduced by $70,000 plus applicable interest, in which case the reduction in Employee's compensation used to repay the amount plus interest (but not the erroneous $70,000 payment) must be reported by Employer as wages on the 2009 Form W–2 issued to Employee and included in Employee's income for 2009. Employer may also adjust Employee's account to reflect the earnings that would have been allocated to Employee's account had the amount been timely deferred and credited to Employee's account balance, if such adjustment for earnings is made on or before December 31, 2009. Alternatively, if it is impracticable to make the adjustment on or before December 31, 2009, such adjustment may be made retroactively to December 31, 2009, provided that Employee and Employer each have a legally binding right on December 31, 2009 with respect to such adjustment.

C. *Incorrect Payment in Violation of § 409A(a)(2)(B)(i) Corrected in the Same Taxable Year*

This section applies to amounts of nonqualified deferred compensation that, under the terms of the plan and any applicable deferral election, and § 409A(a)(2)(B)(i) (requirement to delay for six months payments to a specified employee upon separation from service) and the applicable guidance, should not have been paid or made available to a service provider for at least six months following the service provider's separation from service, but that were paid or made available to the service provider before the expiration of such six-month period due to an unintentional operational failure with respect to the plan. For the ability to correct certain other payments in violation of § 409A and the applicable guidance, see § II.B of this notice.

With respect to an amount to which this § II.C applies, the service provider will not be treated as having failed to comply with § 409A(a)(2)(B)(i) and the terms of the plan and any applicable deferral election as a result of the amount being paid or made available at the earlier date if, on or before the last day of the service provider's taxable year in which the amount was paid or made available, the service provider repays to the service recipient the amount that was erroneously paid or made available to the service provider, immediately after such repayment the service provider has a legally binding right to receive such amount from the service recipient on the date that is the same number of days after the later of (i) the date the amount would otherwise have been payable under the terms of the plan and the applicable deferral election or (ii) the date of the repayment as the number of days from the date the service recipient made the erroneous payment to the service provider through the date the service provider repaid the erroneous payment to the service recipient, and the repaid amount is not paid or made available to the service provider before such date. For purposes of counting days under this § II.C, the first day of the period is disregarded and the last day is taken into account (for example, if on June 1, 2008, a service recipient mistakenly paid a service provider an amount that the service provider repaid on June 30, 2008, there would be 29 days from the date of payment through the date of repayment).

If the requirements of this § II.C are met, the original payment from the service recipient to the service provider that has been repaid to the service recipient is not required to be reported as income on Form W–2 or Form 1099, as applicable. To the extent employment taxes have been withheld and paid with respect to such payment, appropriate adjustments should be made under the applicable rules under § 6413. However, the subsequent payment of the amount by the service recipient to the service provider is required to be reported appropriately as income on Form W–2 or Form 1099, as applicable, and subject to the applicable employment taxes. If the payment is deductible by the service recipient, the taxable year in which such deduction is allowable will be determined in accordance with § 404(a)(5) and the service recipient's method of accounting.

The relief provided in this section is not available with respect to any erroneous payment occurring during any taxable year of the service provider in which the service recipient experienced a substantial financial downturn or otherwise experienced financial or other issues that indicated a significant risk that the service recipient would not be able to pay the amount deferred when the payment became due.

In each of the following examples, it is assumed that: Specified Employee is an individual whose taxable year is the calendar year; at all relevant times Specified Employee is a specified employee of Employer for purposes of § 409A(a)(2)(B)(i); at all relevant times Employer is not experiencing any substantial financial downturn or any other financial or other issue that indicates a significant risk that Employer would not be able to pay the relevant deferred amounts when due; and Employee and Employer each satisfy the other applicable requirements of this § II.

Example 1: Under a nonqualified deferred compensation plan sponsored by Employer, Specified Employee has a legally binding right to a payment of deferred compensation on the first day of the seventh month following Specified Employee's separation from service. Specified Employee separates from service on November 15, 2007 so that the payment

is due on June 1, 2008. Due to an unintentional operational failure with respect to the plan, Employer pays Specified Employee the amount of deferred compensation on May 1, 2008. Employer discovers the error on July 1, 2008, and Specified Employee repays the amount to Employer on July 1, 2008 (61 days after the erroneous payment). Provided that immediately after such repayment Specified Employee has a legally binding right to receive the amount from Employer on August 31, 2008 (61 days after the July 1, 2008 repayment date) and Employer does not repay the amount to Specified Employee before that date, Specified Employee will not be treated as having failed to comply with § 409A(a)(2)(B)(i) and the terms of the plan and the applicable deferral election solely as a result of the early payment.

Example 2: Under a nonqualified deferred compensation plan sponsored by Employer, Specified Employee has a legally binding right to a payment of deferred compensation payable on the first day of the seventh month following separation from service. Specified Employee separates from service on May 1, 2008 so that the payment is due on December 1, 2008. Due to an unintentional operational failure with respect to the plan, Employer pays Specified Employee the amount of deferred compensation on May 1, 2008. Employer discovers the error and Specified Employee repays the amount to Employer on July 1, 2008 (61 days after the erroneous payment). Provided that immediately after such repayment Specified Employee has a legally binding right to receive the amount from Employer on January 31, 2009 (61 days after December 1, 2008) and Employer does not repay the amount to Specified Employee before that date, Specified Employee will not be treated as having failed to comply with § 409A(a)(2)(B)(i) and the terms of the plan and the applicable deferral election solely as a result of the early payment. The erroneous payment is not includible in Specified Employee's income, and is not required to be reported on the 2008 Form W–2. Such amount is includible in Specified Employee's income in the year in which the amount is repaid by Employer to Specified Employee pursuant to the plan, and is required to be reported on that year's Form W–2 and subject to applicable employment taxes.

D. *Excess Deferred Amount Corrected in the Same Taxable Year*

If under the terms of a plan and an applicable deferral election, and § 409A and the applicable guidance, an amount that should not have been deferred compensation under the plan is credited to the service provider's account or otherwise treated as deferred compensation under the plan as a result of an unintentional operational failure with respect to the plan, and such excess amount otherwise would have been paid to the service provider during the service provider's taxable year in which the excess amount was incorrectly credited to the service provider's account or otherwise treated as deferred compensation under the plan, the excess amount is not treated as an amount deferred under the plan if the excess amount is paid to the service provider on or before the last day of the service provider's taxable year in which the excess amount was incorrectly treated as deferred compensation. The amount to which the service provider has a legally binding right under the plan at the end of the year must be adjusted to reflect the payment (for example, through a reduction in the account balance). In addition, if the service provider is an insider with respect to the service recipient (as defined in § II.B of this notice), the remaining account balance (or other deferred compensation under the plan) must be adjusted for positive earnings retroactive to the date the excess amount was incorrectly credited to the service provider's account or otherwise incorrectly treated as deferred under the plan, provided that such adjustment must be made on or before the last day of the service provider's taxable year in which such amount was incorrectly treated as deferred compensation under the plan (or if it is impracticable to make the adjustment by the end of such year, the service recipient must have a legally binding right on the last day of such taxable year to make such adjustment retroactively to such date). In other cases, such adjustment may be (but is not required to be) made. Where the amount was subject to losses, the remaining account balance (or other deferred compensation under the plan) is not required to be adjusted, but may be adjusted for such losses retroactive to the date the excess amount was incorrectly credited to the service provider's account or otherwise incorrectly treated as deferred under the plan, provided that such adjustment must be made on or before the last day of the service provider's taxable year in which such amount was incorrectly treated as deferred compensation under the plan (or if it is impracticable to make the adjustment by the end of such taxable year, the service provider must have a legally binding right on the last day of such taxable year to require that such an adjustment be made retroactively to the date of the failure). The service recipient may (but is not required to) pay reasonable interest to (or otherwise reasonably compensate) the service provider to reflect the time value of money with respect to the late payment, provided that such interest or other compensation is paid or made available by the end of the service provider's taxable year in which such amount was incorrectly treated as deferred compensation under the plan.

This relief is not applicable to a service recipient's failure to timely pay in the proper taxable year of a service provider amounts that were deferred in one or more previous taxable years of the service provider. However, see § 1.409A–3(d) for certain circumstances under which such payments may be treated as made in accordance with a designated payment date.

Example: Employee, who is an insider with respect to Employer and whose taxable year is the calendar year, makes a timely election pursuant to an account balance plan to defer 10% of a bonus otherwise payable in 2007. The bonus is $100,000. Due to an unintentional operational failure with respect to the plan, Employer defers 50% of the bonus, or $50,000, and pays Employee $50,000 (instead of deferring $10,000 and paying Employee $90,000). The excess $40,000 will not be treated as deferred under the plan if on or before December 31, 2007, Employer pays Employee $40,000 of the account balance under the plan, and Employee and Employer each satisfy the other applicable requirements of this § II. The remaining account balance must be adjusted for earnings and may be adjusted for losses that were allocable to such amount under the plan. For example, if the account was credited with 10% in deemed investment earnings, the account balance must be reduced by both the $40,000 paid to Employee and the $4,000 in earnings, or $44,000, to result in the $11,000 account balance that would have been reflected had the deferred compensation under the plan been properly deferred. The adjustment must be made by December 31, 2007, except that the adjustment can be made later, retroactively as of that date, if it is impracticable to make the adjustment by December 31, 2007 and the service recipient has a legally binding right on that date to make such a retroactive adjustment. If the account was charged with 10% in deemed investment losses, the account balance must be reduced by the $40,000, but may be increased not later than December 31, 2007, by the $4,000 in losses on the improperly deferred amount, for a net reduction of $36,000, to result in the $9,000 account balance that would have been reflected had the deferred compensation under the plan been properly deferred. Alternatively, if it is impracticable to make the adjustment on or before December 31, 2007, such $4,000 adjustment may be made later retroactively to December 31, 2007, provided that the service provider has a legally binding right on December 31, 2007, to have such adjustment made. Employer may (but is not required to) pay Employee reasonable interest on the $40,000 erroneous deferral provided such payment is made by December 31, 2007.

E. *Correction of Exercise Price of Otherwise Excluded Stock Rights*

This § II.E applies if under the terms of a stock right, the stock right would

not be nonqualified deferred compensation under § 1.409A–1(b)(5)(i)(A) (excluded stock options) or § 1.409A–1(b)(5)(i)(B) (excluded stock appreciation rights), except that the exercise price of the stock right is less than the fair market value of the underlying stock on the date of grant. This section applies only if the failure of the exercise price to equal or exceed the fair market value of the underlying stock results from an unintentional administrative error in determining the exercise price. If this section applies to a stock right, the stock right is treated from the date of grant as not providing for nonqualified deferred compensation for purposes of § 409A. This section applies if before the stock right is exercised and not later than the last day of a service provider's taxable year in which the service recipient granted the service provider the stock right, the exercise price is reset to an amount equal to or exceeding the fair market value of the underlying stock on the date of grant, and at all times before such increase in the exercise price the stock right otherwise would not have provided for nonqualified deferred compensation for purposes of § 409A. For example, assume that on January 1, 2008, an employer grants an employee a stock option to purchase 100 shares of stock, and the stock option would otherwise be excluded from coverage under § 409A except that due to an unintentional administrative error the exercise price is set at an amount below the fair market value of the stock on January 1, 2008. Assume further that on July 1, 2008, the employee partially exercises the stock option and purchases 40 shares, but retains a stock option to purchase 60 shares. Provided that on or before December 31, 2008, the exercise price of the remaining stock option to purchase 60 shares is reset to a price at or above the fair market value of the underlying stock on January 1, 2008, the stock option to purchase 60 shares may qualify for the relief provided in this section. Because the exercise price was not reset before July 1, 2008, the portion of the stock option that was exercised to purchase 40 shares is not eligible for the relief provided in this section.

III. TRANSITION RELIEF FOR CERTAIN OPERATIONAL FAILURES INVOLVING LIMITED AMOUNTS OCCURRING DURING TAXABLE YEARS BEGINNING BEFORE 2010

A. *General Requirements*

If an unintentional operational failure to comply with § 409A(a) occurs during a service provider's taxable year beginning before January 1, 2010, but the operational failure qualifies for the relief provided in this § III and is corrected in accordance with this § III, the amount required to be included in income under § 409A(a) as a result of the failure, and the resulting additional taxes under § 409A, are limited in accordance with the provisions of this section. In each instance, the taxpayer claiming the relief (the service provider, the service recipient, or both) has the burden of demonstrating that such taxpayer was eligible for the relief and that the requirements of this section have been met. Any application of the relief provided in this section is subject to examination by the IRS.

The relief provided by this section applies only to unintentional operational failures, which means an unintentional failure to comply with plan provisions that satisfy the requirements of § 409A(a) and the guidance thereunder, or an unintentional failure to follow the requirements of § 409A in practice, due to one or more inadvertent errors in the operation of the plan. This notice does not apply to plan terms that fail to meet the requirements of § 409A and applicable guidance or to operational failures for which a correction is not provided in this § III.

The relief provided under this § III is not available unless, in addition to correcting the operational failure in accordance with this § III, the service recipient takes commercially reasonable steps to avoid a recurrence of the operational failure. For any taxable year of the service provider beginning after December 31, 2008, if the same or a substantially similar operational failure has occurred previously, the service recipient must demonstrate that the service recipient had established practices and procedures reasonably designed to ensure that such an operational failure would not recur, had taken commercially reasonable steps to avoid a recurrence of the operational failure and that the operational failure occurred despite the diligent efforts of the service recipient. Relief otherwise available under this § III is conditioned upon the timely filing and providing of the information required by § IV of this notice.

The relief provided by this section is not available with respect to any failure unless all of the requirements of this section (other than the requirements of § IV of this notice) have been satisfied not later than the end of the second taxable year of the service provider following the taxable year of the service provider in which such failure occurred. In addition, the relief provided in this section is not available if a federal income tax return of the service provider for the taxable year of the service provider in which the failure occurred is under examination with respect to the plan. For this purpose, an individual service provider is treated as under examination with respect to the plan if the individual is under examination with respect to the individual's federal income tax return (for example, Form 1040) for the taxable year.

Relief is not available under this § III with respect to any intentional failure to comply with the terms of a plan or the requirements of § 409A in the operation of a plan. The relief provided in this section also is not available with respect to an operational failure that is egregious, or where the failure is directly or indirectly related to participation in an abusive tax avoidance transaction (meaning for this purpose any listed transaction under § 1.6011–4(b)(2)). The relief provided in this section also is not available with respect to a failure to comply with § 409A resulting from an exercise of a stock right.

B. *Failure to Defer Limited Amount not Corrected in the Same Taxable Year and Certain Erroneous Payments*

This § III.B applies if during a service provider's taxable year beginning before January 1, 2010, an unintentional operational failure occurs that meets the following requirements:

(1) An amount should have been treated as deferred compensation under the terms of the plan and any applicable deferral election, and § 409A and the applicable guidance, but the amount was not credited

to the service provider's account or otherwise treated as deferred compensation during the service provider's taxable year, or did not remain deferred compensation after the end of such year;

(2) Because the amount was not credited to the service provider's account or otherwise treated as deferred compensation under the plan during such year, or did not remain deferred compensation under the plan after the end of such year, the amount was paid or made available to the service provider during the service provider's taxable year;

(3) Section II.B of this notice does not apply because relief is not available under § II.B of this notice with respect to the failure, the failure is not corrected under § II.B of this notice, or otherwise; and

(4) The amount paid or made available to the service provider does not exceed the limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B) for the year of the operational failure.

In such a case, if the plan is otherwise compliant with the requirements of § 409A and the applicable guidance, the amount includible in income under § 409A(a) as a result of such payment is limited to the amount that should have been treated as deferred compensation under the plan (or should have continued to be deferred compensation under the plan) but was instead paid or made available to the service provider, and does not include any other amounts deferred under the plan. In addition, with respect to such amount includible in income under § 409A(a), the service provider is required to pay the additional tax under § 409A(a)(1)(B)(i)(II) (the additional 20% tax), but is not required to pay the additional tax under § 409A(a)(1)(B)(i)(I) (the premium interest tax).

For purposes of this section, a payment of an amount (including a payment of an amount that is one of a series of installment payments or life annuity payments) that under the terms of the plan and § 409A(a)(2)(B)(i) and the applicable guidance is required to be delayed for at least six months following a separation from service, but is paid before the completion of that six months, may be treated as the payment of an amount that should have continued to be deferred compensation. In addition, for purposes of this section, the plan includes any arrangements treated as a single plan under § 1.409A–1(c), so that this section will apply only if any and all erroneous payments under the plan, in the aggregate, of amounts that otherwise should have been treated as deferred compensation with respect to the service provider during the taxable year (or should have continued to be deferred compensation during the taxable year), do not exceed the limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B) for such year. The relief provided in this § III.B is not available if the operational failure occurred during a taxable year of the service provider in which the service recipient experienced a substantial financial downturn or otherwise experienced financial or other issues that indicated a significant risk that the service recipient would not be able to pay the amount deferred when the payment became due.

It is assumed for purposes of the following examples that: Employee is an individual whose taxable year is the calendar year; Employee's tax return is not under examination for any relevant period; during all relevant periods Employer did not experience any financial downturn or financial or other issues indicating a significant risk that Employer would not be able to pay relevant deferred amounts when due; and Employee and Employer each satisfy the other applicable requirements of this § III.

Example 1: Employee makes a timely election to defer 10% of a bonus payable in 2007 pursuant to an account balance plan. The bonus is $10,000. Due to an unintentional operational failure with respect to the plan, Employer defers only 8% of the bonus, or $800, and pays Employee $9,200 (instead of deferring $1,000 and paying Employee $9,000). The amount is not corrected by December 31, 2007, when Employee's account balance is $100,000. As a payment to Employee, Employer must treat the amount as a wage payment for employment tax and reporting purposes, as appropriate, including reporting as income and wages on the 2007 Form W–2. Employer is permitted to report as income under § 409A on the 2007 Form W–2 (or 2007 Form W–2c), Box 12, using Code Z, only $200, and Employee is permitted to include in income under § 409A for 2007 only $200. Furthermore, Employee is permitted to pay the additional 20% tax only with respect to the $200 (or $40 in additional income tax), and is not required to pay the premium interest tax.

Example 2: Employee is a specified employee entitled under a nonqualified deferred compensation plan to a life annuity commencing upon the first day of the seventh month following the specified employee's separation from service. The annuity payments are $2,000 per month. Employee separates from service on April 18, 2007, and is scheduled to receive an initial annuity payment on November 1, 2007. Due to an inadvertent miscalculation of the specified employee's separation from service date, Employee receives a $2,000 payment on October 1, 2007, before the end of the 6-month period following Employee's separation from service. Employer and Employee do not discover the error until 2008, so that the relief provided in § II.C of this notice is not available. As a payment to Employee, Employer must treat the amount as a wage payment for employment tax and reporting purposes, as appropriate, including reporting as income on the 2007 Form W–2. Employer is permitted to report as income under § 409A on the 2007 Form W–2 (or 2007 Form W–2c), Box 12, using Code Z, only $2,000, and Employee is permitted to include in income under § 409A in 2007 only $2,000. Furthermore, Employee is permitted to pay the additional 20% tax only with respect to the $2,000 (or $400 in additional income tax), and is not required to pay the premium interest tax.

C. *Limited Excess Deferred Amount not Corrected in the Same Taxable Year*

This § III.C applies if on or before the last day of a service provider's taxable year beginning before January 1, 2010, the following requirements are met:

(1) Under the terms of the plan and any applicable deferral election, and § 409A and the applicable guidance, an amount of deferred compensation under the plan should have been paid or made available to the service provider during the service provider's taxable year, or an amount is treated as deferred compensation under the plan that should have been paid or made available to the service provider during the service provider's taxable year, but such amount is not paid or made available due to an unintentional operational failure with respect to the plan;

(2) Section II.D of this notice does not apply because relief is not available under § II.D of this notice with respect to the failure, the failure is not corrected under § II.D of this notice, or otherwise;

(3) The amount that should have been paid or made available to the service provider during that service provider's taxable year does not exceed the limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B) for such year;

(4) By the later of the end of the service provider's taxable year in which the failure is discovered or the fifteenth day of the third month following the date upon which the failure is discovered, the service recipient pays the service provider the amount that should have been paid or made available to the service provider, provided that

any earnings allocable to such amounts through the date of the payment are either forfeited or added to the payment to the service provider, and any losses allocable to such amounts through the date of the payment are either permanently disregarded or subtracted from the payment to the service provider, and the service recipient reports such payment on a Form W–2 or Form 1099, as applicable, in accordance with the requirements of this section; and

(5) The service provider includes such amount in income and pays the additional taxes under § 409A(a) as described in this section on a timely filed federal income tax return (including an income tax return filed in accordance with a timely request for extension, but not including an amended income tax return).

In such a case, if the plan otherwise complies with the requirements of § 409A and the applicable guidance, the amount includible in income under § 409A(a) as a result of such failure is limited to the excess amount paid to the service provider, and does not include any other deferred compensation under the plan, and the amount is includible in income only when paid to the service provider in accordance with this section. In addition, with respect to this amount includible in income under § 409A(a), the service provider is required to pay the additional 20% tax, but is not required to pay the premium interest tax. If the service recipient properly reports the payment as includible in income under § 409A on a Form W–2, if applicable, for the year in which the payment was made, including reporting such amount on Form W–2, Box 12 using Code Z, the service recipient will not be subject to penalties or liability for the failure to properly withhold under § 3402.

For purposes of this section, the plan includes any arrangements treated as a single plan under § 1.409A–1(c), so that this section will apply only if any and all erroneous deferrals under the plan, in the aggregate, of amounts that otherwise should have been paid during the service provider's taxable year to the service provider do not exceed the applicable limit on elective deferrals that would apply to a qualified plan under § 402(g)(1)(B).

Example: Employee, who has a calendar year taxable year, makes a timely election to defer 8% of a bonus payable in 2007 into an account balance plan. The bonus is $10,000. Due to an unintentional operational failure with respect to the plan, Employer defers 10% of the bonus, or $1,000, and pays Employee $9,000 (instead of deferring $800 and paying Employee $9,200). The plan otherwise complies with § 409A and the applicable guidance. Employer discovers the error on February 1, 2008, so that the excess deferred amount of $200 is not corrected by December 31, 2007. On March 1, 2008, at which time Employee's account balance includes $15 in earnings on the excess $200 credited to the account, Employer pays Employee $215. Employer reports the $215 as income under § 409A on the 2008 Form W–2, Box 1 and Box 12, using Code Z and satisfies the other applicable requirements of this § III, including the requirements of § IV of this notice. Provided that Employee reports such income and pays the applicable taxes, including the additional § 409A taxes, on a timely filed 2008 Form 1040 (including a 2008 Form 1040 filed under extension, but not an amended 2008 Form 1040), and satisfies the applicable requirements of § IV of this notice, Employee is not required to include any additional amounts deferred under the plan in income under § 409A(a) or to include any amount in income under § 409A for years before 2008, and with respect to the $215 includible in income under § 409A is required to pay only the additional 20% tax (or $42.50 in additional income tax), and not the premium interest tax. Employer may also have paid Employee only the $200 excess deferred amount if the $15 in earnings on such amount were forfeited.

IV. INFORMATION AND REPORTING REQUIREMENTS

A. *Information Required with Respect to Correction of an Operational Failure in the Same Taxable Year as the Failure Occurs*

A service recipient described in § II of this notice must attach to its timely-filed (including extensions) original federal income tax return for its taxable year in which the failure occurred a statement entitled "§ 409A Relief under § II of Notice 2007–100" setting out the information required by § IV.A.1 of this notice, and must provide to each service provider affected by such failure a statement entitled "§ 409A Relief under § II of Notice 2007–100" setting out the information required by § IV.A.2 of this notice by no later than the date (with extensions) on which it is required to provide an information return (Form W–2 or 1099) to such service provider for the calendar year in which such failure occurred (or if no information return is required for such service provider, not later than the January 31 following the calendar year in which such failure occurred). Notwithstanding the foregoing, to qualify for the relief described in § II.E of this notice (Correction of Exercise Price of Otherwise Excluded Stock Rights), the service recipient is not required to provide a statement to such service provider with respect to such failure. In addition, each taxpayer relying on the relief provided in § II of this notice must provide notice to the examining agent upon the commencement of an examination of such taxpayer's federal tax return that the taxpayer was relying upon the relief provided under this notice for years covered by the examination (except in the case of a service provider for whom a correction has been made under § II.E of this notice).

1. *Attachment to Service Recipient Tax Return for Failures Described in § II*

The service recipient must attach a statement to its federal income tax return stating that it is relying upon § II of this notice with respect to a correction of a failure to comply with § 409A and setting out the following information with respect to each such failure:

a. The name and taxpayer identification number of each service provider affected by the failure and whether such service provider is an insider with respect to the service recipient. Where the same or a substantially similar operational failure has occurred with respect to multiple service providers, the information required in § IV.A.1.b through e of this notice may be supplied only once with respect to such operational failure, provided that the identification of each service provider affected by the operational failure in this § IV.A.1.a references such information and the amount involved in the operational failure with respect to such service provider.

b. Identification of the nonqualified deferred compensation plan with respect to which such failure occurred.

c. A brief description of the failure and the circumstances under which it occurred, including the amount involved and date on which the failure occurred.

d. A brief description of the steps taken to correct the failure and the date on which such correction was completed.

e. A statement that the operational failure is eligible for the correction under the terms of this notice, and that the service recipient has taken all actions required, and otherwise met all requirements, for such correction.

2. *Information to be Provided to Service Provider for Failures Described in § II*

The service recipient must provide the following information to each service provider affected by correction of a failure to comply with § 409A who is entitled to relief under § II of this notice (other than § II.E of this notice (Correction of Exercise Price of Otherwise Excluded Stock Rights)) with respect to such failure:

a. A statement that the service provider is entitled to the relief provided in § II of this notice with respect to a failure to comply with § 409A.

b. The information described in § IV.A.1.b through e of this notice.

B. *Information Required with Respect to Transition Relief for Certain Operational Failures Involving Limited Amounts*

A service recipient described in § III.B or III.C of this notice must attach to its timely-filed (including extensions) original federal income tax return for its taxable year in which it discovers the failure a statement entitled "§ 409A Relief under § III of Notice 2007–100" setting out the information required by § IV.B.1 of this notice and, not later than the date (with extensions) on which it is required to provide an information return (Form W–2 or 1099) for the calendar year in which it discovers such failure to a service provider who is affected by such failure (or if no information return is required for such service provider, not later than the January 31 following the calendar year in which it discovers such failure), must provide to each such service provider a statement entitled "§ 409A Relief under § III of Notice 2007–100" setting out the information required by § IV.B.2 of this notice. A service provider who is relying on the relief provided in § III.B or III.C of this notice with respect to a failure to comply with § 409A must attach to the service provider's timely-filed (including extensions) original federal income tax return for the year in which such failure was discovered the information required by § IV.B.3 of this notice. In addition, each taxpayer relying on the relief provided in § III of this notice must provide notice to the examining agent upon the commencement of an examination of such taxpayer's federal tax return that the taxpayer was relying upon the relief provided under this notice for years covered by the examination.

1. *Attachment to Service Recipient Tax Return for Failures Described in § III.B or III.C.*

The service recipient must attach a statement to its return setting out the following information with respect to each failure described in § III.B or III.C of this notice:

a. The name and taxpayer identification number of each service provider affected by the failure. Where the same or a substantially similar operational failure has occurred with respect to multiple service providers, the information required in § IV.B.1.b through e of this notice may be supplied only once with respect to such operational failure, provided that the identification of each service provider affected by the operational failure in this § IV.B.1.a references such information and the amount involved in the operational failure with respect to such service provider.

b. Identification of the nonqualified deferred compensation plan with respect to which such failure occurred.

c. A brief description of the failure and the circumstances under which it occurred, including the amount involved and date on which the failure occurred.

d. A brief description of the steps taken by the service recipient to avoid a recurrence of the failure, including the date on which such steps were implemented.

e. A statement that the operational failure is eligible for the correction under the terms of this notice, and that the service recipient has taken all actions required, and otherwise met all requirements, for such correction.

2. *Information to be Provided to Service Provider for Failures Described in § III.B or III.C.*

The service recipient must provide the following information to each service provider affected by a failure to comply with § 409A who is entitled to relief under § III.B or III.C of this notice with respect to such failure:

a. A statement that the service provider is entitled to the relief provided in § III.B or III.C of this notice (as applicable) with respect to a failure to comply with § 409A and that the service provider must attach a copy of the statement to the service provider's income tax return for the taxable year in which the failure was discovered.

b. The information described in § IV.B.1.b through e of this notice.

3. *Attachment to Service Provider Tax Return for Failures Described in § III.B or III.C.*

The service provider must attach to the service provider's income tax return a copy of the statement the service provider received from the service recipient with respect to each such failure.

V. POTENTIAL PROGRAM TO CORRECT CERTAIN FAILURES TO COMPLY WITH § 409A(a) IN OPERATION

The Treasury Department and the IRS are considering establishing a corrections program under which taxpayers could correct certain failures to comply with § 409A(a) in the operation of a nonqualified deferred compensation plan (operational failures), including correction after the end of the service provider's taxable year in which an operational failure occurs. The Treasury Department and the IRS request comments on all aspects of this potential program. For information regarding the submission of comments, see § VI of this notice.

The program under consideration would cover failures that are not eligible for the transition relief provided in § III of this notice because the amount involved is too large. The program may also provide that the relief in § III for failures involving small amounts would be available permanently. In addition, it is expected that the program under consideration would, in general, permit a service provider with respect to whom an operational failure occurred that is addressed by the program but not eligible for the relief provided in § III of this notice, to include an amount in income, and pay the additional taxes under § 409A with respect to, only the amount involved in the operational failure, and not other amounts deferred under the plan. For example, if a service provider erroneously

deferred an additional $50,000 to a plan under which the service provider had previously deferred $1,000,000 (for a total of $1,050,000), and the $50,000 deferral and the error were corrected pursuant to the program, the service provider would not be required to include in income under § 409A, and pay the additional § 409A taxes with respect to, the $1,000,000 deferred under the plan that was not involved in the operational failure.

The Treasury Department and the IRS anticipate that the IRS would not issue a ruling, enter into a closing agreement or otherwise issue any formal approval evidencing that participating taxpayers had met the requirements of, and qualified for the relief available under, the program. Rather, if the IRS examined the relevant tax returns, the service recipient and service provider would have the burden of demonstrating that the applicable requirements had been met. The corrections program would be restricted to service providers that at the time of the correction are not under examination for the year or years in which the operational failure occurred, and would be limited to operational failures that are corrected promptly after discovery and in any case within two years after the occurrence. As part of the corrections program, the service recipient and the service provider would be required to satisfy information and reporting requirements substantially similar to those set forth in § IV.B of this notice and the service recipient and service provider would also be required to provide notice to the examining agent upon the commencement of an examination that the taxpayer was relying upon the relief provided under the program for years covered by the examination.

The Treasury Department and the IRS anticipate that the program would include the following limitations and requirements:

- Relief would only be available with respect to an operational failure that has occurred notwithstanding the service recipient's reasonable efforts to comply with the terms of the plan. Thus relief would only be available if the service recipient had established practices and procedures reasonably designed to ensure compliance with § 409A.

- Relief would only be available with respect to an operational failure if the service recipient also took commercially reasonable steps to avoid a recurrence of the same type of operational failure.

- Relief would also not be available to correct an operational failure that is egregious, intentional, or where the failure is directly or indirectly related to participation in an abusive tax avoidance transaction (meaning for this purpose any listed transaction under §1.6011–4(b)(2)).

- If the operational failure involved an accelerated payment that did not otherwise satisfy the plan's terms and the requirements of § 409A(a), the correction of the failure would require that the service provider return to the service recipient the amount improperly paid by the service provider to the service recipient. The service provider would not be entitled to any loss or deduction for either the year of the repayment or the year to which the correction applied. However, if the plan does not otherwise violate the provisions of § 409A and the applicable guidance, the service provider would be required thereafter to include in gross income only additional amounts subsequently paid from such plan (as if the amount taken into gross income in the year of the failure resulted in investment in the contract with respect to the amount that was actually included in gross income for the year of the erroneous payment).

- Relief would not be available for an accelerated payment that did not otherwise satisfy the terms of the plan and the requirements of § 409A(a) if the service recipient made the payment proximate to a financial downturn of the service recipient or the service recipient experiencing any financial or other issue that indicated a significant risk that the service recipient would not be able to pay the amount deferred when the payment became due under the plan.

- If the operational failure involved an amount that was improperly deferred (for example, the deferral of salary in excess of the applicable deferral election under the terms of the plan), or an amount of deferred compensation that was not paid to the service provider on the date applicable under the terms of the plan, the correction of the operational failure would require that the service recipient pay the amount to the service provider. The service provider would be required to include the amount in gross income in the service provider's taxable year in which the failure occurred and not at the time the service recipient made the corrective payment, with the service provider being required to report the amount on an original or amended return for such year and pay the appropriate tax thereon.

- Investment earnings (potentially including losses) in accordance with the terms of the plan for the period of time after the operational failure through the date of correction would be required to be taken into account.

- In addition to the requirement of income inclusion described above, the service provider would be required to pay income taxes, including the additional § 409A taxes (and any applicable interest on the underpayment of such § 409A taxes), as applicable. The service recipient would be required to file with the IRS and provide to the service provider a Form W–2c or corrected Form 1099, as applicable. If the service recipient and service provider met the requirements for the correction program, the service recipient would not be liable for any failure to withhold income taxes on the amount required to be included in income under § 409A as a result of the operational failure, to the extent the amounts required to be included in income had not been paid or made available to the service provider.

- Some or all of the relief may be available only to service providers that are not insiders with respect to the service recipient.

VI. SUBMISSION OF COMMENTS

The Treasury Department and the IRS are currently considering formulating gen-

eral guidance on the correction of operational failures under a nonqualified deferred compensation plan resulting in a failure to meet the requirements of § 409A. Some of the guidance being considered has been set forth in this notice. The Treasury Department and the IRS request comments on all aspects of a potential corrections program, including but not limited to the topics addressed in this notice and specifically request comments on the following:

- With respect to the program under consideration described in § V of this notice, potential methods of tracking the "investment in the contract" created when an amount is included in income under § 409A but not yet paid to the service provider.
- With respect to the program under consideration described in § V of this notice, potential methods of addressing the service recipient's deduction for payments made, and the affect of repayments by the service provider to the service recipient on such deductions.

Comments must be submitted by March 3, 2008. All materials submitted will be available for public inspection and copying. Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2007–100), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2007–100), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2007–100) in the subject line.

VII. EFFECT ON OTHER DOCUMENTS

For service recipients and service providers who are entitled to relief under this notice, Notice 2006–100, 2006–51 I.R.B. 1109 (relating to reporting and wage withholding for 2006) and Notice 2007–89, 2007–46 I.R.B. 998 (relating to reporting and wage withholding for 2007) are modified to conform to the provisions of this notice with respect to (i) the amount that is required to be included in income by a service provider under section 409A(a), and (ii) the amount that is required to be reported by the service recipient as an amount includible in income under section 409A(a) on Form W–2, Box 1 and Box 12, using Code V, or Form 1099–MISC, Box 7 and Box 15b, as applicable.

VIII. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 USC. 3507) under control number 1545–2086.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in this notice is in section IV. This information is required to determine whether the taxpayers claiming the relief are eligible for the relief and that the applicable requirements for relief are met. The likely respondents are corporations and individuals.

The estimated annual reporting and/or recordkeeping burden is 5,000 hours.

The estimated annual burden per respondent/recordkeeper is .5 hours.

The estimated number of respondents is 10,000.

The estimated annual frequency of response is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax return and tax return information are confidential, as required by § 6103.

IX. DRAFTING INFORMATION

The principal authors of this notice are Stephen Tackney and Bill Schmidt of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury and IRS officials participated in its development. For further information on the provisions of this notice, contact Stephen Tackney or Bill Schmidt at (202) 927–9639 (not a toll-free number).

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2007–101

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining

the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–36 I.R.B. 366.

The composite corporate bond rate for November 2007 is 6.14 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted Average	Permissible Range		
Month	*Year*		90%	to	100%
December	2007	5.90	5.31		5.90

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. For plan years beginning in 2008 and 2009, a transitional rule under § 430(h)(2)(G) provides that the segment rates are blended with the corporate bond weighted average as specified above. An election may be made under § 430(h)(2)(G)(iv) to use the segment rates without applying the transitional rule.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, the 24-month average corporate bond segment rates, and the funding transitional segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from November 2007 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of November 2007 are, respectively, 4.92, 6.02 and 6.47. The three 24-month average corporate bond segment rates applicable for December 2007 under the election of § 430(h)(2)(G)(iv) are as follows:

First Segment	Second Segment	Third Segment
5.31	5.90	6.41

The transitional segment rates under § 430(h)(2)(G) applicable for December 2007, taking into account the corporate bond weighted average of 5.90 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.70	5.90	6.07

30-YEAR TREASURY SECURITIES INTEREST RATE

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for November 2007 is 4.52 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in May 2037.

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) of the Code are segment rates computed without regard to a 24-month average. For plan years beginning in 2008 through 2011, the applicable interest rate is the monthly spot

segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for November 2007, taking into account the November 2007 30-year Treasury rate of 4.52 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	4.60	4.82	4.91

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for October 2007

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	5.04	20.5	6.32	40.5	6.49	60.5	6.55	80.5	6.58
1.0	4.86	21.0	6.33	41.0	6.49	61.0	6.55	81.0	6.58
1.5	4.73	21.5	6.33	41.5	6.50	61.5	6.55	81.5	6.58
2.0	4.68	22.0	6.34	42.0	6.50	62.0	6.55	82.0	6.58
2.5	4.70	22.5	6.35	42.5	6.50	62.5	6.55	82.5	6.58
3.0	4.79	23.0	6.36	43.0	6.50	63.0	6.55	83.0	6.58
3.5	4.90	23.5	6.36	43.5	6.50	63.5	6.56	83.5	6.58
4.0	5.03	24.0	6.37	44.0	6.51	64.0	6.56	84.0	6.58
4.5	5.15	24.5	6.38	44.5	6.51	64.5	6.56	84.5	6.58
5.0	5.27	25.0	6.38	45.0	6.51	65.0	6.56	85.0	6.58
5.5	5.38	25.5	6.39	45.5	6.51	65.5	6.56	85.5	6.58
6.0	5.47	26.0	6.39	46.0	6.51	66.0	6.56	86.0	6.59
6.5	5.56	26.5	6.40	46.5	6.51	66.5	6.56	86.5	6.59
7.0	5.63	27.0	6.40	47.0	6.52	67.0	6.56	87.0	6.59
7.5	5.70	27.5	6.41	47.5	6.52	67.5	6.56	87.5	6.59
8.0	5.76	28.0	6.41	48.0	6.52	68.0	6.56	88.0	6.59
8.5	5.81	28.5	6.42	48.5	6.52	68.5	6.56	88.5	6.59
9.0	5.86	29.0	6.42	49.0	6.52	69.0	6.56	89.0	6.59
9.5	5.90	29.5	6.42	49.5	6.52	69.5	6.57	89.5	6.59
10.0	5.94	30.0	6.43	50.0	6.52	70.0	6.57	90.0	6.59
10.5	5.97	30.5	6.43	50.5	6.53	70.5	6.57	90.5	6.59
11.0	6.01	31.0	6.44	51.0	6.53	71.0	6.57	91.0	6.59
11.5	6.04	31.5	6.44	51.5	6.53	71.5	6.57	91.5	6.59
12.0	6.06	32.0	6.44	52.0	6.53	72.0	6.57	92.0	6.59
12.5	6.09	32.5	6.45	52.5	6.53	72.5	6.57	92.5	6.59
13.0	6.11	33.0	6.45	53.0	6.53	73.0	6.57	93.0	6.59
13.5	6.13	33.5	6.45	53.5	6.53	73.5	6.57	93.5	6.59
14.0	6.15	34.0	6.46	54.0	6.54	74.0	6.57	94.0	6.59
14.5	6.17	34.5	6.46	54.5	6.54	74.5	6.57	94.5	6.59
15.0	6.19	35.0	6.46	55.0	6.54	75.0	6.57	95.0	6.59
15.5	6.20	35.5	6.47	55.5	6.54	75.5	6.57	95.5	6.59
16.0	6.22	36.0	6.47	56.0	6.54	76.0	6.57	96.0	6.59
16.5	6.23	36.5	6.47	56.5	6.54	76.5	6.57	96.5	6.59
17.0	6.25	37.0	6.47	57.0	6.54	77.0	6.58	97.0	6.59
17.5	6.26	37.5	6.48	57.5	6.54	77.5	6.58	97.5	6.59
18.0	6.27	38.0	6.48	58.0	6.54	78.0	6.58	98.0	6.60
18.5	6.28	38.5	6.48	58.5	6.55	78.5	6.58	98.5	6.60
19.0	6.29	39.0	6.48	59.0	6.55	79.0	6.58	99.0	6.60
19.5	6.30	39.5	6.49	59.5	6.55	79.5	6.58	99.5	6.60
20.0	6.31	40.0	6.49	60.0	6.55	80.0	6.58	100.0	6.60

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 860D, 860G, 1001; 1.860G–2, 1.1001–3, 301.7701–2, 301.7701–3, 301.7701–4.)

Rev. Proc. 2007–72

SECTION 1. PURPOSE

This revenue procedure describes the conditions under which changes to certain subprime mortgage loans will not cause the Internal Revenue Service to challenge the tax status of certain securitization vehicles holding the loans.

The purpose of this revenue procedure is to provide certainty in the current economic environment with respect to certain potential tax issues that may be implicated by fast track loan modifications, as described below. No inference should be drawn about whether similar consequences would obtain if a transaction falls outside the limited scope of this revenue procedure. Furthermore, there should be no inference that this revenue procedure is necessary to prevent transactions within its scope from impacting the tax status of securitization vehicles.

SECTION 2. BACKGROUND-THE ASF "FRAMEWORK"

.01 On December 6, 2007, the American Securitization Forum ("ASF") released a document entitled, "Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans" (the "Framework"). An Executive Summary of the Framework (entitled "Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans") was released simultaneously and is attached as an Appendix to this revenue procedure.

.02 The Framework has been broadly supported as an appropriate step in addressing certain risks in the current economic environment.

.03 The Framework applies to first-lien subprime residential adjustable rate mortgage (ARM) loans that—

(1) Have an initial fixed rate period of 36 months or less (including "2/28s" and "3/27s");

(2) Were originated between January 1, 2005, and July 31, 2007;

(3) Are included in securitized pools; and

(4) Have an initial interest rate reset between January 1, 2008, and July 31, 2010.

This revenue procedure refers to these instruments as "Loans."

.04 The Framework provides a "fast track" procedure for modifying Loans and details the criteria for determining which Loans are eligible for the procedure. Modifications pursuant to the procedure are referred to as "fast track modifications."

.05 In a fast track modification, a borrower is offered a Loan modification under which the interest rate on the affected Loan will be kept at the existing rate, generally for five years following the date on which the rate would have reset in the absence of the modification.

SECTION 3. BACKGROUND—REMICS

.01 Real Estate Mortgage Investment Conduits (REMICs) are widely used securitization vehicles for mortgages. REMICs are governed by sections 860A through 860G of the Internal Revenue Code.

.02 For an organization to qualify as a REMIC, all of the interests in the organization must consist of one or more classes of regular interests and a single class of residual interests, *see* section 860D(a), and those interests must be issued on the startup day, within the meaning of § 1.860G–2(k) of the Income Tax Regulations.

.03 A regular interest is one that is designated as a regular interest and whose terms are fixed on the startup day. Section 860G(a)(1). In addition, a regular interest must (1) unconditionally entitle the holder to receive a specified principal amount (or other similar amount), and (2) provide that interest payments, if any, at or before maturity are based on a fixed rate (or to the extent provided in regulations, at a variable rate).

.04 An interest issued after the startup day does not qualify as a REMIC regular interest.

.05 An entity qualifies as a REMIC only if, among other things, as of the close of the third month beginning after the startup day and at all times thereafter, substantially all of its assets constitute qualified mortgages and permitted investments. *See* section 860D(a)(4). An entity that initially qualifies as a REMIC may cease to qualify, if a sufficiently large portion of its qualified mortgages are significantly modified and the modified obligations are not qualified mortgages. *See* § 1.860G–2(b)(1). For this purpose, a qualified mortgage is generally treated as having been significantly modified if the change in terms would be treated as an exchange of obligations under section 1001 and the regulations thereunder. *See* § 1.860G–2(b)(2).

.06 Certain changes in the terms of an obligation, however, are not significant modifications for this purpose, regardless of whether they are significant modifications under section 1001 and § 1.1001–3. *See* § 1.860G–2(b)(3). In particular, changes in the terms of an obligation "occasioned by default or a reasonably foreseeable default" are not significant modifications for this purpose. *See* § 1.860G–2(b)(3)(i).

.07 Section 860F(a)(1) imposes a tax on REMICs equal to 100 percent of the net income derived from "prohibited transactions." The disposition of a qualified mortgage is a prohibited transaction unless the disposition is pursuant to (i) the substitution of a qualified replacement mortgage for a qualified mortgage; (ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage; (iii) the bankruptcy or insolvency of the REMIC; or (iv) a qualified liquidation. Section 860F(a)(2)(A).

SECTION 4. BACKGROUND—TRUSTS

.01 Section 301.7701–2(a) of the Procedure and Administration Regulations defines a "business entity" as any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701–3) that is not properly classified as a trust under § 301.7701–4 or otherwise subject to special treatment under the Code.

.02 Section 301.7701–4(a) provides that an arrangement is treated as a trust if the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are

not associates in a joint enterprise for the conduct of business for profit.

.03 Section 301.7701–4(c) provides that an "investment" trust is not classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders.

SECTION 5. SCOPE

.01 This revenue procedure applies to the following transactions occurring on or before July 31, 2010—

(1) A fast track modification of a Loan pursuant to the Framework; and

(2) A second-lien holder's action of subordinating its lien to any new lien that may arise under a Loan as the result of a fast track modification.

.02 If the Framework is materially modified after December 6, 2007, this revenue procedure does not necessarily apply to fast track modifications under the revised Framework or to second-lien subordinations to accommodate those modifications.

SECTION 6. APPLICATION

In the case of one or more transactions to which this revenue procedure applies—

.01 The Internal Revenue Service will not challenge a securitization vehicle's qualification as a REMIC on the grounds that the transactions are not among the exceptions listed in § 1.860G–2(b)(3);

.02 The Internal Revenue Service will not contend that the transactions are prohibited transactions under section 860F(a)(2) on the grounds that the transactions are not among the exceptions listed in section 860F(a)(2)(A)(i)–(iv);

.03 The Internal Revenue Service will not challenge a securitization vehicle's classification as a trust on the grounds that the transactions manifest a power to vary the investment of the certificate holders; and

.04 The Internal Revenue Service will not challenge a securitization vehicle's qualification as a REMIC on the grounds that the transactions resulted in a deemed reissuance of the REMIC regular interests.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective beginning December 6, 2007.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information, contact Ms. Imholtz at (202) 622–3930 (not a toll-free call).

Appendix to Revenue Procedure 2007–72

American SECURITIZATION FORUM®

American Securitization Forum

Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans

Executive Summary

December 6, 2007

***Scope*:**

This streamlined framework applies to all first lien subprime residential adjustable rate mortgage (ARM) loans that have an initial fixed rate period of 36 months or less (including "2/28s" and "3/27s"), referred to below as "subprime ARM loans" that:

- were originated between January 1, 2005 and July 31, 2007;
- are included in securitized pools; and
- have an initial interest rate reset between January 1, 2008 and July 31, 2010.

This streamlined framework would be applied to subprime ARM loans in advance of an initial reset date. Typically, servicer/borrower communication should begin 120 days prior to the initial reset date.

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www.americansecuritization.com

Overarching Principles:

- The servicer will not take any action that is prohibited by the pooling and servicing agreement ("PSA") or other applicable securitization governing document, or that would violate applicable laws, regulations, or accounting standards. ASF's Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, published concurrently with this document, analyzes how the framework described in the Executive Summary is consistent with typical PSA provisions. The ASF urges readers of this Executive Summary to review the full Statement.

- The ASF believes that this framework is consistent with the authority granted to a servicer to modify subprime mortgage loans in typical PSAs. The ASF expects that the procedures in this framework will constitute standard and customary servicing procedures for subprime loans.

- The servicer will expeditiously implement the ASF Investor Reporting Guidelines for the Modification of Subprime ARM Loans recommended by the ASF, which is simultaneously released with this framework.

- LTV and CLTV will be determined based on information at origination. If an origination LTV is below 97%, a servicer may obtain an updated home value by obtaining an AVM, BPO or other means.

- All servicers of second liens to subprime borrowers should cooperate fully with this framework by providing information needed by first lien servicers and by agreeing to subordinate the second lien to any new first lien resulting from a refinance (with no cash out) under this framework.

- All existing contractual obligations and remedies related to fraudulent mortgage origination activity should be strictly enforced.

- The streamlined framework outlined in this framework represents the consensus view of the membership of the ASF, acting through its Board of Directors, as to the parameters used to determine the segmentation of subprime ARM loans, including the numeric values included in those parameters. It is understood by the ASF's members that the numeric values included in the parameters are not based on historic data, but rather simply represent a consensus view as to appropriate numeric values for use within this framework for the purpose of supporting a streamlined approach to loan modifications that complies with typical securitization governing documents. The ASF, acting through its Board of Directors, may in the future change these numeric values or further refine these parameters as experience is gained and market conditions evolve.

***Borrower Segmentation*:**

Under this framework, subprime ARM loans are divided into 3 segments.

Segment 1 includes current (as defined below) loans where the borrower is likely to be able to refinance into any available mortgage product, including FHA, FHA Secure or readily available mortgage industry products.

- Generally, the servicer will determine whether loans may be eligible for refinancing into readily available mortgage industry products based on ascertainable data not requiring direct communication with the borrower, such as LTV, loan amount, FICO and payment history. Servicers will generally not determine current income or DTI to determine initial eligibility for refinancing.

- If the borrower also has a second lien on the property, this framework contemplates that the borrower is able to refinance the first lien only, on a no cash out basis. In order for the loan to fall into this segment, the second lien does not have to be refinanced; however, any second lien holder will need to agree to subordinate their interest to the refinanced first lien.

Segment 2 includes current loans where the borrower is unlikely to be able to refinance into any readily available mortgage industry product.

- *Current*: For purposes of this framework "current" means the loan must be not more than 30 days delinquent, and must not have been more than 1 x 60 days delinquent in the last 12 months, both under the OTS method. Corresponding tests would apply under the MBA method if the servicer uses that standard.

- *LTV test*: All current loans with an LTV (based on the first lien only) greater than 97% are deemed not to be eligible for refinance into any available product, and thus are within Segment 2. (97% is the maximum LTV allowed under FHA Secure.)

- *Not FHA Secure eligible*: All current loans that otherwise do not satisfy FHA Secure requirements, including delinquency history, DTI at origination and loan amount standards for this program, are within Segment 2 unless the servicer can determine whether they may meet eligibility criteria for another product, by reviewing eligibility criteria without performing an underwriting analysis.

Segment 3 includes loans where the borrower is not current as defined above, demonstrating difficulty meeting the introductory rate.

Segment 1 — Refinance:

- It is expected that borrowers in this category should refinance their loans, if they are unable or unwilling to meet their reset payment. However, a servicer may evaluate each borrower in this category on a case by case basis or apply any framework consistent with the applicable servicing standard in the transaction documents for a loan modification or other loss mitigation outcome.

- The servicer will facilitate a refinance in a manner that avoids the imposition of prepayment penalties wherever feasible. This may be accomplished by timing the refinance to occur after the upcoming reset date.

- Servicers should take all reasonable steps permitted under the PSA and other governing documents to encourage or facilitate refinancing for borrowers in Segment 1, or to borrowers in Segment 2 who become eligible for a refinance, including, where permitted, providing borrowers with information about FHA, FHA Secure and other readily available mortgage industry products, even if that servicer is not able to provide those products through any affiliated originator.

Segment 2 — Loan Modification:

- The servicer will determine the following for each Segment 2 borrower: current owner occupancy status (based on information known to the servicer, including billing and property address), current FICO score and the FICO score at origination of the loan.

- FICO test:

  - If the current FICO score is less than 660 and is less than a score 10% higher than the FICO score at origination, the borrower is considered to have met the "FICO test." If the borrower meets the FICO test, the servicer will generally not determine the borrower's current income.

  - If either a) the current FICO score is 660 or higher, or b) the current FICO is at least 10% higher than the FICO score at origination, the borrower is considered to not meet the "FICO test." If the borrower does not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification.

- Segment 2 loans will only be eligible for a fast track loan modification if:

  - The borrower currently occupies the property as his or her primary residence;

  - The borrower meets the FICO test; and

  - The servicer determines that, at the upcoming reset, the payment amount would go up by more than 10%.

- Borrowers in this segment and eligible for a fast track loan modification as described above may be offered a loan modification under which the interest rate will be kept at the existing rate, generally for 5 years following the upcoming reset.

- As to Segment 2 loans eligible for a fast track loan modification, the servicer may make the following presumptions:
  - The borrower is able to pay under the loan modification based on his or her current payment history prior to the reset date.
  - The borrower is willing to pay under the loan modification, as evidenced by a) an agreement to the modification after being contacted or b) in the event that the affirmative agreement of the borrower cannot be obtained, the borrower's payment of two payments under the loan as modified after receiving notice of the modified terms.
  - The borrower is unable to pay (and default is reasonably foreseeable) after the upcoming reset under the original loan terms, based on the size of the payment increase that would otherwise apply.
  - The modification maximizes the net present value of recoveries to the securitization trust and is in the best interests of investors in the aggregate, because refinancing opportunities are likely not available and the borrower is able and willing to pay under the modified terms.
- For borrowers that do not meet the FICO test, the servicer will use an alternate analysis to determine if the borrower is eligible for a loan modification, as well as the terms of the modification (which may vary). This may include a) conducting an individual review of current income and debt obligations, debt-to-income analysis, and considering a tailored modification for a borrower, or b) applying any other framework consistent with the applicable servicing standard in the transaction documents to determine if a borrower is eligible for a loan modification.
- For borrowers that are eligible for a fast track modification, the fast track option is non-exclusive and does not preclude a servicer from using an alternate analysis to determine if a borrower is eligible for a loan modification, as well as the terms of the modification.

Segment 3 — Loss Mitigation:

- For loans in this category, the servicer will determine the appropriate loss mitigation approach in a manner consistent with the applicable servicing standard in the transaction documents, but without employing the fast tracking procedures described under Segment 2. The approach chosen should maximize the net present value of the recoveries to the securitization trust. The available approaches may include loan modification (including rate reduction and/or principal forgiveness), forbearance, short sale, short payoff, or foreclosure.
- These borrowers will require a more intensive analysis, including where appropriate current debt and income analysis, to determine the appropriate loss mitigation approach.

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Information Reporting for Lump-Sum Timber Sales

REG–155669–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the information reporting requirements contained in section 6045(e) of the Internal Revenue Code (Code) on sales or exchanges of standing timber for lump-sum (outright) payments. The proposed regulations amend §1.6045–4 of the Income Tax Regulations to require real estate reporting persons, as defined in section 6045(e)(2) of the Code, to report lump-sum payments received by sellers (landowners) for sales or exchanges of standing timber. This action is being taken to make the reporting requirements for lump-sum sales of standing timber consistent with the reporting requirements applicable to pay-as-cut timber sales. The proposed regulations do not change the information reporting requirements that currently apply to sales or exchanges of standing timber for pay-as-cut (contingent) payments under section 6050N of the Code.

DATES: Written or electronic comments and requests for a public hearing must be received by February 27, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–155669–04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–155669–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–155669–04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulation, Julie Hanlon-Bolton of the Office of Chief Counsel (Procedure and Administration), at (202) 622–7028; for questions concerning submissions of comments, contact Kelly Banks at (202) 622–7180.

SUPPLEMENTARY INFORMATION:

Background

This document contains a proposed amendment to the Income Tax Regulations under section 6045(e). The amendment imposes information reporting requirements on sales or exchanges of standing timber for lump-sum payments, commonly referred to as lump-sum or outright timber sales. A lump-sum contract provides for a pre-set, fixed, and non-contingent payment in exchange for the right to cut and remove designated trees. In these transactions, sellers of standing timber receive fixed payments that are not based on the amount of the timber actually cut. The sellers do not retain any economic interest in the timber and bear no risk of loss upon execution of the sales contract.

Sales or exchanges of standing timber for contingent payments, commonly referred to as pay-as-cut timber sales, allow purchasers to cut designated trees in exchange for a payment that is based on a specified rate for each unit of timber actually cut and measured. In these transactions, sellers of standing timber receive payments that are contingent on the amount of timber actually cut. The sellers retain an economic interest in the timber and continue to bear economic risk associated with the sales contract until the timber is actually cut and removed.

Because the sellers of standing timber who enter into pay-as-cut transactions retain an economic interest until the timber is actually cut and removed, the payments are characterized as timber royalties reportable under section 6050N on Form 1099–S, *"Proceeds From Real Estate Transactions."* See Announcement 90–129, 1990–48 I.R.B. 10.

However, currently, no information reporting obligation applies to a sale or exchange of standing timber for a lump-sum payment. The information reporting requirements of section 6050N do not apply to a sale or exchange of timber for a lump-sum payment because the seller retains no economic interest and bears no economic risk of loss in the timber upon execution of the sales contract.

Recognizing the disparate treatment in the reporting of timber sale and exchange transactions, the Treasury Department has reconsidered the information reporting requirements under section 6045(e) as they apply to lump-sum sales or exchanges of standing timber and has decided to amend the regulations to require information reporting for these transactions.

Currently, section 6045(e) requires a "real estate reporting person," as defined in section 6045(e)(2), to make an information return and furnish a statement to the transferor with respect to a real estate transaction that consists in whole or in part of the sale or exchange of "reportable real estate." Section 1.6045–4(b)(2) defines "reportable real estate" as, among other things, any present or future ownership interest in land. Section 1.6045–4(c)(2)(i) provides that no return of information is required with respect to a sale or exchange of an interest in timber, provided that the sale or exchange of such property is not related to the sale or exchange of reportable real estate.

The preamble to §1.6045–4 provides background information concerning the exception for timber sales in §1.6045–4(c)(2)(i), stating in pertinent part as follows:

> The proposed regulations provided an exception from the reporting requirements for transactions involving natural resources, including standing timber. Section 6050N of the Code requires reporting for certain royalty payments, including timber royalties, but not for other transactions involving timber. The IRS believes that the disparity in the reporting requirements for different forms of timber transactions may be inappropriate. However, this issue was not addressed in the public comments and was not considered at the public hearing. Accordingly, the final regulations contain the exception for natural resource transactions, including standing timber. The IRS will open a new

regulations project to consider the expansion of the reporting requirements to include sales and exchanges of standing timber. Any requirements for the reporting of standing timber will apply only to transactions occurring after the issuance of such requirements. See 55 FR 51282, T.D. 8323.

The IRS has found that some taxpayers are underreporting income from lump-sum or outright sales of timber, resulting in a loss of tax revenue. Additionally, the Treasury Department and the IRS do not think that the disparate treatment of lump-sum and pay-as-cut timber transactions for information reporting purposes is in the interests of sound tax administration. Based on considerations of tax policy and sound tax administration, the Treasury Department has decided to amend the regulations under section 6045(e) to require information reporting for sales or exchanges of standing timber for lump-sum payments.

This amendment provides that sales or exchanges of standing timber for lump-sum payments are "reportable real estate" transactions under §1.6045–4(b)(2) and, thus, shall be reported as provided in section 6045(e) and the regulations.

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by February 27, 2008. The Treasury Department is interested in comments on the following:

Whether the proposed collection of information is necessary for the proper performance of the function of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information affected by this proposed regulation is described in §1.6045–4. The collection of information is mandatory. The likely respondents are for-profit corporations and small business entities.

Estimated total annual reporting burden: 10,000 hours.

Estimated average annual burden hours per respondent: .5 hours.

Estimated number of respondents: 20,000.

Estimated frequency of responses: annually.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue Law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Proposed Effective Date

These amendments shall apply to sales or exchanges of standing timber for lump-sum payments completed on or after the date of publication of a Treasury decision adopting these rules as final regulations in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that collection of information in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information burden imposed by these regulations flows directly from section 6045(e) of the Code. Moreover, requiring information reporting as described in the preamble with regard to sales or exchanges of standing timber for lump-sum payments imposes minimal burden in time or expense. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required. The IRS invites comments on the accuracy of this certification. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Julie A. Hanlon-Bolton of the Office of Associate Chief Counsel (Procedure and Administration). However, other personnel from the IRS and the Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6045–4 is amended by:

1. Redesignating paragraphs (b)(2)(i), (b)(2)(ii), (b)(2)(iii), and (b)(2)(iv) as paragraphs (b)(2)(i)(A), (b)(2)(i)(B), (B)(2)(i)(C), and (b)(2)(i)(D), respectively.
2. Adding paragraph (b)(2)(i)(E).
3. Redesignating paragraph (b)(2) introductory text as (b)(2)(i) introductory text.
4. Designating the undesignated text as paragraph (b)(2)(ii).
5. Adding a new last sentence at the end of newly designated paragraph (b)(2)(ii).
6. Revising paragraph (c)(2)(i) and paragraph (s).

The revisions and additions read as follows:

§1.6045–4 Information reporting on real estate transactions with dates of closing on or after January 1, 1991.

* * * * *

(b) * * *

(2)* * * (i) * * *

(E) Any non-contingent interest in standing timber.

(ii) * * * Further, the term *ownership interest* includes any contractual interest in a sale or exchange of standing timber for a lump-sum payment that is fixed and not contingent.

* * * * *

(c) * * *

(2) * * *

(i) An interest in surface or subsurface natural resources (for example, water, ores, and other natural deposits) or crops, whether or not such natural resources or crops are severed from the land. For purposes of this section, the terms "natural resources" and "crops" do not include standing timber.

* * * * *

(s) *Effective/applicability date.* This section applies for real estate transactions with dates of closing (as determined under paragraph (h)(2)(ii) of this section) that occur on or after January 1, 1991. The amendments to paragraphs (b)(2)(i)(e), (b)(2)(ii) and (c)(2)(i) of this section shall apply to sales or exchanges of standing timber for lump-sum payments completed after the date specified in the final regulations.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 28, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 29, 2007, 72 F.R. 67589)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Notification Requirement for Tax-Exempt Entities Not Currently Required to File

REG–104942–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9366) describing the time and manner in which certain tax-exempt organizations not currently required to file an annual information return under section 6033(a)(1) are required to submit an annual electronic notice including certain information required by section 6033(i)(1)(A) through (F). The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by February 13, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–104942–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA: LPD:PR (REG–104942–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC., or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–104942–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Monice Rosenbaum at (202) 622–6070 (not a toll-free number); concerning submission of comments and requests for a public hearing, Richard Hurst, *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these proposed regulations has been reviewed by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The information that is required to be collected for purposes of §1.6033–6(c) is required to be submitted on Form 990–N, *"Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990–EZ,"* under control number 1545–2085. The estimated number of recordkeepers that will submit electronic notification is approximately 520,000. The estimated paperwork burden for taxpayers submitting Form 990–N is 15 minutes per taxpayer.

Books and records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Background and Explanation of Provision

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) relating to sec-

tion 6033(i)(1). The temporary regulations describe the time and manner in which certain tax-exempt organizations not currently required to file are required to provide an annual electronic notice including certain information set forth in the section 6033(i)(1)(A) through (F). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in §1.6033–6T will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. 601) (RFA) is not required.

The effect of these proposed regulations on small entities flows directly from the statute these regulations implement. Section 6033(i)(1) requires that certain entities submit annual notification, in electronic form, setting forth: the legal name of the organization; any name under which such organization operates or does business; the organization's mailing address and Internet Web site address (if any); the organization's taxpayer identification number; the name and address of a principal officer; and evidence of the continuing basis for the organization's exemption from the filing requirements under section 6033(a)(1).

Pursuant to section 7805(f) of the Code, this regulation as been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. Comments are requested on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Monice Rosenbaum of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6033–6 also issued under 26 U.S.C. 6033(i)(1). * * *

Par. 2. Section 1.6033–6 is proposed to be added to read as follows:

§1.6033–6 Notification requirement for entities not required to file an annual information return under section 6033(a)(1) (taxable years beginning after December 31, 2006).

[The text of proposed §1.6033–6 is the same as the text of §1.6033–6T published elsewhere in this issue of the Bulletin].

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 14, 2007, 8:45 a.m., and published in the issue of the Federal Register for November 15, 2007, 72 F.R. 64174)

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The abbreviation and number in parenthesis following the index entry refer to the specific item; the number in italic type following the parenthesis refers to the page number on which the item appears.

Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
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TDO	Treasury Department Order

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Proposed Regulations:

26 CFR 301.6343–2, amended; 301.7425–3, amended; changes to office to which notices of nonjudicial sale and requests for return of wrongfully levied property must be sent (REG–148951–05) *550*; correction (Ann 94) *858*

SELF-EMPLOYMENT TAX —Cont.

Regulations:

26 CFR 301.6343–2, amended; 301.6343–2T, added; 301.7425–3, amended; 301.7425–3T, added; changes to office to which notices of nonjudicial sale and requests for return of wrongfully levied property must be sent (TD 9344) *535*; correction (Ann 93) *858*

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